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Canadian Consumer Loan Association

Hearings held at

OTTAWA

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ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,
Ontario, on Tuesday,
September 25th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
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Corporation Executive
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Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

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Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

* Absent

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ROYAL COMMISSION ON [illegible]

[illegible]

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Hearings held at [illegible]
[illegible], [illegible],
[illegible]

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[illegible]

The Honourable [illegible]
[illegible]
Toronto, Ontario - [illegible]

Dr. [illegible]
[illegible]
Vancouver, British Columbia

Mr. [illegible]
[illegible]
[illegible], Ontario

Mr. [illegible]
[illegible]
[illegible], Ontario

Dr. Paul [illegible]
[illegible]
[illegible]

* Dr. Jean [illegible]
[illegible]
[illegible]

Dr. [illegible]
Vice-Chancellor
Queen's University
Kingston, Ontario

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Mr. [illegible] - Secretary

Mr. [illegible] - [illegible]

* Absent

Ottawa, Ontario,
Tuesday,
September 25, 1962.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

CANADIAN CONSUMER LOAN ASSOCIATION

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APPEARANCES

F. C. Oakes	-	Chairman, Board of Directors, C.C.L.A. Director of Public Relations, Household Finance Corporation of Canada, Toronto.
F. S. Picard	-	Director, C.C.L.A. President, Lucerne Finance Corp., Ltd., Montreal.
C. M. Cawker	-	Director, C.C.L.A. President, Lombank Finance (Eastern) Ltd., Belleville
A. M. Masson	-	Director, C.C.L.A. President, Independent Finance Corporation, Ltd., Oakville
D. F. McClure	-	Senior Vice-President Household Finance Corporation, Chicago.
A. K. Eaton	-	Consultant, C.C.L.A. Director, Beneficial Finance Co. of Canada, Toronto

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THE CHAIRMAN: I will now call the meeting to order.

This morning we have a submission from the Canadian Consumer Loan Association. Perhaps your spokesman would introduce the delegation.

MR. OAKES: Good morning, Mr. Chairman and gentlemen, my name is Frederick Oakes. I am chairman of the board of directors of the Canadian Consumer Loan Association, and also director of public relations, Household Finance Corporation of Canada, Toronto.

With your permission, Mr. Chairman, I would like to introduce my colleagues here: Mr. F. S. Picard, director, Canadian Consumer Loan Association, president, Lucerne Finance Corp., Ltd., Montreal; Mr. C. M. Cawker, director, Canadian Consumer Loan Association, president, Lombank Finance (Eastern) Ltd., Belleville; Mr. A. M. Masson, director, Canadian Consumer Loan Association, president, Independent Finance Corporation, Ltd., Oakville; Mr. D. F. McClure, senior vice-president, Household Finance Corporation, Chicago; and Dr. A. K. Eaton, consultant, Canadian Consumer Loan Association, director, Beneficial Finance Co. of Canada, Toronto.

When we initially submitted our brief in July, Mr. Chairman, we had intended at that time to make an opening statement. The opening statement on behalf of the Association was to be read by Dr. A. K. Eaton. However, I understand it is the wish of the Commission that we proceed with the main subject matter.

THE CHAIRMAN: We have all read the statement, and I think it is unnecessary to read it again. However,

the official reporters might incorporate it in the proceedings, if that is satisfactory.

MR. OAKES: We would appreciate that, sir; thank you.

" SUMMARY AND OPENING STATEMENT

Submitted to

ROYAL COMMISSION ON BANKING AND FINANCE

on behalf of

CANADIAN CONSUMER LOAN ASSOCIATION

" INTRODUCTION

1. In July the Canadian Consumer Loan Association submitted a brief to this Commission. Mainly this presentation was descriptive. It set forth the important facts about the kind of business carried on by the members of this Association as well as telling of the activities of the Association itself.

2. Helpful advice was given to us by your Secretariat as a guide in the process of selection so that in enthusiasm to tell all the account would not be over-loaded with matters not of direct concern to the Commission. The result is a document which we think gives a precise and informative account of affairs in our industry. In a sense it is a quite human document. It gives a picture of the part played by our industry in carrying on a useful community service, mainly in

urban areas.

CASE FOR IMMUNITY FROM ANY CONTROL

3. Four sets of facts which we think are particularly significant to our case emerged from this presentation -

(1) Consumer loan companies as such (members of our Association) supply only a very small part of the credit extended to consumers in Canada - 14.4%. If to consumer loans and credit were added chartered bank loans 'other than personal loans' - this being the larger overall total of credit under monetary authority - it is found that consumer loan companies are responsible for only about 6% of total loans and consumer credit in Canada. Quite clearly our industry is not important to monetary authorities in ordinary overall credit control policy.

(2) The most frequent sort of loan made in our business is for the consolidation of existing debts rather than for additional spending - about 32% of the total. Another group adding up to over 30% of the total are mainly to meet unusual emergency demands such as for sickness, moving expenses, clothing, repairs, taxes, insurance, education and assisting relatives. Travel claims about 11%. Loans for the purchase of automobiles amount to 11.08% of the total but it is fair to assume that this is almost entirely for the purchase of second-hand cars - plain transportation. Clearly these are not the sort of loans that should

be subject to restrictive pressure from monetary policy under any circumstances.

(3) The largest number of our borrowers fall in the 25-29 age group and over one-third are in the \$300-\$400-a-month income group. About 47% are skilled or semi-skilled workers. Mostly our borrowers are young married couples with a moderate income needing occasional accommodation.

(4) In times past it has been believed by some that our companies have literally driven people into debt by aggressive pressure for more business. The facts today show that this is far from the truth. Only about half of those who come to us for loans are able to meet our credit standards.

4. These facts are summarized here in support of the proposition that, if for any reason the Commission has in mind recommending any general extension of control over credit in Canada our industry should be left alone. 77% of our business is already well regulated under the Small Loans Act.

5. The brief submitted in July was primarily descriptive of our industry. This present submission is mainly analytical and argumentative. It will conclude that in the general field of credit control the status quo should be maintained, that present methods available for credit control in Canada are adequate for the purpose.

NO CASE FOR LAW LIMITING CONSUMER CREDIT

6. Before discussing certain technical aspects of our business in relation to the matters being looked into

by the Commission it would be appropriate, we think, to comment on a general question which, to say the least, is of importance to our industry. The question is whether consumer credit in Canada has gone beyond safe limits, whether the buy-now-pay-later vogue is dangerous and if so what, if anything, should be done about it. We would like to place our views on this question before you. This subject may sound a bit professorial but we are not so modest as to suggest that our views, the facts on which they are based and our day to day experience in this field would not be of value in arriving at a sound conclusion.

7. In any capitalist community there is always a group of savers, people who want to postpone consumption or who are willing to do so at a price - a lending rate of interest. Also in the same community there is a group who want the immediate use of savings of others for business purposes or as in our case to advance the time of consumption. This group need or want somebody else's savings now and for this they are willing to pay a price - a borrowing rate of interest. These are both natural phenomena in our economy and over all the pricing process governs and acts as a regulator.

8. Supply and demand, the lenders and borrowers are brought together in offices from coast to coast by members of our Association who are businessmen and have realized that here, just as in all other sections of the private enterprise economy, profits may be made by securing supply at a price and meeting demand at a sufficiently higher price to cover costs and afford a

reasonable profit in doing so. That about sums it up.

9. The suggestion that there might possibly be need for measures to check the expansion of consumer debt bothers us a bit and we confess we do not see the basis on which any government interference with the operation of ordinary market processes in this field could be justified.

10. Surely consumers rather than their government are the best judges of the extent to which they want to borrow at a price to finance present consumption as against waiting to pay for it out of their own savings. It is a simple question of when and at what price.

11. It might possibly be suggested that the country would be better off if more of the available savings were devoted to financing capital expansion in the business world rather than used to accommodate immediate consumption. This argument, we believe, will not stand up. The volume of savings in a free economy, in the absence of artificial interference very properly flows in the direction where demand reflected in price pulls it. If, therefore, there is fair competition for the use of capital in the community, and we believe there is, it is our contention that the greatest economic good for the country as a whole results from this free play of economic forces through the pricing system. We do not think a tenable case can be made for interference with it by political authority. We realize that an attitude of smug paternalism comes quite easily - all too easily - in discussion of consumer credit but we do not think there is a sound basis for a

policy based on this attitude.

12. It is very easy these days to go into debt. Advertising media are currently crowded with invitations to the public to buy now and pay later, sponsored by so-called hard-headed businessmen. Human nature being what it is it is perhaps not surprising that this appeal makes headway. Quite obviously it is the vogue these days but we suggest that the immoderation of a small percentage in this direction is over emphasized. Certainly in our view there is nothing in the situation for national concern. Our industry can predict with considerable certainty that in many directions these apparently generous offers of credit will be found not to be profitable and will be discontinued. Collection costs, delinquencies and defaults can very soon play havoc with profit margins. This our industry very well knows from experience.

13. We believe that ordinary business prudence will be the factor which will reduce offers of consumer credit to reasonable proportions. We believe that the experience of our industry bears this out.

14. Perhaps from the facts of earlier and out-dated times some people still believe that small loan companies practically force lower income groups into debt at unconscionable interest rates. This simply is not true. The plain fact is that our offices from coast to coast receive a steady demand for credit. For the industry as a whole scarcity of willing customers is not the problem. The truth of this statement as stated earlier is borne out by the fact

that about half of the total applications for loans that come into our offices are turned down because the would-be borrowers cannot meet our standards of credit worthiness.

15. We do not claim that this policy reflects altruism on our part in protecting would-be borrowers against themselves. The plain fact is that we are merely protecting ourselves against unduly high collection costs, losses and inevitable bankruptcy. As a result of these prudent lending policies delinquents in instalment repayments of loans in our industry are not unreasonable. This, we suggest, is a reflection of good businesslike conditions in our industry. Our write-offs for bad debts are consistently less than 1% of total loans. This, we submit, is the best evidence that for our industry at least, loans in relation to income of borrowers, are on an eminently sound and reasonable basis.

16. So when it is suggested that there may be danger inherent in the level of consumer debt in relation to income our answer is that so far as our industry is concerned there is no danger whatsoever. As a matter of ordinary business prudence we see to it that debt does not get out of line with income borrowers. Our small loss ratio bears this out.

17. It is common knowledge that practically all our members advertise to attract more business. All try to attract their own share of credit-worthy borrowers. They naturally continue to do this even though about half the applications have to be refused

because further debt would go beyond our criteria of debt in relation to income. We think the advertising in our industry is merely a healthy reflection of a good competitive situation in an important field of business.

CONVENTIONAL MONETARY CONTROLS NOT APPROPRIATE

18. In the opening portion of this submission it was argued that the nature of our loans and the type of person to whom they are made are such that this lending activity should always remain outside the scope of restrictive pressure from monetary policy. In no sense can our loans generally be regarded as inflationary, contributing toward price instability in the business world. It is now proposed to examine various technical aspects of our industry to show how inappropriate it would be to attempt to apply ordinary conventional methods of central banking control in our case.

19. Briefly stated, the mechanism of monetary policy is based on the fact that banks accept deposits from the public and the law requires them to keep a reserve of cash on hand against them. Deposits are of two kinds, demand and saving and because of the existence of the former the banks are persuaded in practice to maintain over and above cash a certain ratio of liquid assets to these deposits. The chartered banks hold large portfolios of Government securities both long and short term. They are large and frequent dealers in securities. The regulative power of the Bank of Canada over them rests in the fact that

the Bank of Canada can alter the percentage of cash which the chartered banks must keep against deposits. The Bank can also instantly increase or decrease the volume of cash (deposits in the Bank) outstanding available for reserves by buying or selling securities - open market operations.

20. A mere glance at the balance sheet of a small loan company will show how meaningless it would be to attempt to extend these conventional methods of central bank control to our industry. It was stated above that the control mechanism is based on the fact that the banks accept deposits. Our industry does not have deposit liabilities. We have no general outstanding liabilities to the public and not being vulnerable to withdrawals we have no reason whatsoever to maintain cash reserves. Cash on hand in our industry is kept at the very minimum consistent with the ordinary operations of doing business. Our objective is to be completely loaned up at all times.

21. Similarly with no deposit liabilities to the general public liquidity is not important to us in this respect. Ordinarily we have no occasion to hold Treasury Bills or to invest in short-term paper. We rarely buy or sell government securities. It is clear that the control mechanism developed over the banking system is founded upon the natural and inherent functions and vulnerabilities of the banks. It would be quite meaningless to attempt to apply the same requirements to our industry. It would just not make sense.

DEPOSITS IN THE BANK OF CANADA AS A REQUIREMENT

22. It might be suggested that for control purposes our companies should be required to maintain deposits in the Bank of Canada equal to some proportion of their outstanding loans, i.e., equal to some proportion of their assets, not their liabilities. We think we understand the reasons why banks found it prudent and subsequently were required by law to maintain cash reserves against deposit liabilities but it is a quite different matter, without deposit liabilities to be required to sterilize a certain proportion of company capital setting it permanently aside for no use whatsoever. This would merely destroy the usefulness of a certain portion of our capital and accordingly, would reduce the profitability of our business to no good purpose. Incidentally, it might be noted that open market operations of the Bank of Canada which so directly influence the volume of cash deposits in the Bank held by the chartered banks, would pass our companies by completely since they do not accept deposits and do not deal in government securities.

CONTROL OVER FLOW OF FUNDS INTO CONSUMER CREDIT

23. Since the ordinary methods of central bank control over credit are not appropriate to the situation in our industry it might be suggested as an alternative that there should be some direct control over the flow of funds into our industry for re-lending. This thought is a bit overwhelming in its implication.

24. A glance at the liabilities side of the balance

sheets of our companies will show some variety in the source of loan funds with considerable difference as between companies. This is not surprising in view of their diversity in size and status. Some are controlled while others have no affiliations at all with other companies. Equity capital, of course, is a common source of funds for all but its importance is not the same for all companies. Perhaps about the only generalization that can be made about the source of loan funds is that in the main they come from long-term borrowing. Probably it would be fair to say that in this dynamic business expansion of operations is generally financed through short-term obligations which are subsequently funded into long-term debt once the higher level of business has been consolidated. This seems to be the natural pattern of development. However, after having said this it must be admitted that there is no very deep significance in the distinction between long and short-term indebtedness between controlled and controlling companies. The distinction here is essentially quite artificial. At this point it might be mentioned that about 65% of the small loan business in Canada is in the hands of two companies which are wholly-owned by United States companies carrying on the same business. This the Commission should know in attempting to assess conditions in our industry, particularly with respect to this question about the source of funds.

25. While long-term borrowing for short-term re-lending is the general rule our companies, without exception, do resort to short-term financing. Some,

particularly the larger well known companies, sell their notes to various categories of industrial companies who at times have idle funds for temporary investment. But mainly the source of short-term funds, apart from financing through affiliates, is the chartered banks. All of our companies depend on bank credit to some extent but again in varying degrees.

26. One can scarcely visualize the complex of controls that would be necessary under these circumstances to regulate the total flow of funds into the small loan industry if that were deemed desirable. Furthermore, if the flow of funds into our industry were regulated it must be assumed that sales financing generally and consumer retail credit would likewise have to be brought under similar control. It is suggested that with this volume and variety of lenders and creditors it would be little short of fantastic to try to prescribe limitations on the sources of funds lent or credit granted. It would involve a bureaucratic exercise beyond the scope of anything seen in peace-time in a so-called free enterprise economy. And even then it could not possibly be done fairly.

27. It was mentioned above that all our member companies depend on the bank borrowing to some extent as a source of loan funds. From this it might be argued that central bank pressure on the chartered banks will work its way down into lessened accommodation for consumer loan companies forcing them to reduce their volume of re-lending. This might seem to be a fair answer to those who think they see the need for

control over small loans and consumer credit. We do not think, however, that this would be a very well founded conclusion. Actually for our industry as a whole absolute dependence on borrowing from Canadian banks is really not so important as might appear on the surface.

28. It was mentioned above that 65% of the small loans in Canada are made by two companies which are wholly-owned by U.S. companies in the same business. Both of these companies habitually borrow quite heavily from Canadian banks. They regard it as good business to match assets in one currency with liabilities in the same currency. But it must be realized that in periods of stringency this rule can be relaxed. At such times the parent companies may be able to help them out at less cost than alternative sources of funds in Canada. However, it must not be lightly assumed that additional funds are always readily available from parent companies in the United States. Usually at any point of time the trend of monetary policy is the same in both countries and it may be no easier or cheaper for the parent to secure banking accommodation in the United States than it is for the subsidiary to secure funds in Canada.

29. In any event our brief submitted to the Commission in July records the fact that the effects of a tight money policy hit very unevenly the operations of our member companies. Quite frankly we do not think we could with much assurance assert that through pressure from the chartered banks in a tight money period the

total of small loans outstanding would likely decrease or even stop increasing if the demand from credit-worthy borrowers kept up as it usually does in periods of prosperity. We can, however, assert with some certainty that the costs of borrowing for re-lending would increase.

30. Of course our industry is in no way apologetic over the fact that restrictive monetary policy operating through the banking system cannot be said to be a very effective restraint on the volume of our business. As we stated at the outset we think our loans are of the kind that should not be interfered with. We think we have established a good case for deploring the fact that restrictive monetary policy has any effect whatsoever on our ability to make loans. This being so we argue that it would be quite in order in times of credit stringency that the chartered banks be instructed to see to it that normal accommodation would continue for members of our Association. In such ways can monetary policy become less the proverbial blunt instrument.

DIRECT CONTROLS BY IMPOSING CEILINGS

31. We should like to comment on the use of ceilings as a device for direct enforcement of limitations, or even contractions in consumer lending. This idea is, of course, not new in Canada and was resorted to through official persuasion in the tight money period of 1956. Incidentally, we would like to record the fact that it was never regarded as necessary or desirable to request our companies to in any way limit the scope of their lending. We think this is understandable since

it would be little less than material fallacy to regard the activities of our industry as inflationary.

32. Apart from endorsing continued immunity for our industry from ceilings on the volume of business in tight money periods we would like to make two points on this subject.

(1) Any such action should have law and regulations behind it if it is to operate beyond the range of the chartered banks. The chartered banks are firmly built into our financial pattern. Their position in the community is solidly based and long established. They have a keen appreciation of their responsibilities and are accustomed to working closely with both Central Bank and Department of Finance. This is definitely not the case for the wide variety of business institutions, both large and small, new and old, domestic and foreign that make up the complex of those who in the business world offer accommodation where ready cash is not available in the hands of those who want it. It is no reflection on this type of operator to say that gentlemen's agreements do not fit well into this milieu. Experience has shown that what is needed if restraint is to be effective is some pretty tough and arbitrary law backed up by pages of regulations.

(2) The second point we submit in this connection is that any such law supported by even voluminous regulations is almost by definition bound to be

unfair. The insidious thing about ceilings is that they sound so simple and reasonable but after all they are based essentially on the same principle as an excess profits tax and no one who has had experience in this field can but cringe at the mere mention of it. A base is taken from which to prescribe a penalty or prohibition on excess performance. There never seems to be a normal base period certainly not for all companies concerned. Forever there will be hardship cases that simply cannot be ignored in a democratic society. Protest and resentment can cause even the most ardent economic planner to question the practical wisdom of his ideas of regulating or controlling business activities of this kind. Experience in this field is very disillusioning for him who regards controls as relatively simple and straightforward matters. This about sums up our views on direct control in the field of consumer lending. They are stated with sincerity and considerable conviction.

GENERAL COMMENT ON SCOPE OF MONETARY POLICY

33. The above analysis and argument has been devoted mainly to what might be called the technical aspects of control to give effect to general monetary policy. It is now proposed to offer some more general comment on the broad question of monetary policy. Should the range of monetary policy be extended? Over how wide an area should controls be pushed? It is

suggested here that the danger of so-called inflation and the need for a broader base on which monetary policy and control over credit should operate has been vastly exaggerated in recent years.

34. Classical inflationary forces based on scarcities relative to demand operated in Canada for some years after the War and price increases under these conditions were the order of the day. About when pric levels might have been stabilized the Korean episode brought new trouble into the picture. Nothing, monetary policy or drastic fiscal policy could be expected to be of any avail whatsoever against the panic buying and hoarding which accompanied the desperate prospects of renewed world turmoil. So prices surged upward in this period and as we know they never seem to drop back again to previous levels once the disturbance is over.

35. The Korean episode drove the consumer price index up by about 15%. By 1952-53 the index stood at about 115. It took a full decade for the index to move another 15 points. It now stands at about 130. The effects of recent devaluation and tariff surcharges will doubtless appear shortly but one trusts no one will associate this upward change with internal inflation based on scarcities.

36. The point being suggested here is that price level increases in Canada since 1952 have not been due to what are usually understood as inflationary forces which traditionally are amenable to central bank control. It has been a decade of relatively good business in Canada

with a few slow-downs and pauses scarcely extending beyond inventory levels. Withall in this period there have been no hectic boom situations characterized by commodity scarcities giving rise to runaway price situations. Yet prices have quite consistently edged gradually upward in good times as well as in the less good periods. Surely it is almost self-evident that this so-called price inflation, this gradual upward trend of prices is not a product of positive monetary inflation of the classical sort. And if this is so it is equally evident that monetary policy must be quite ineffective in stemming it. Not long past in Canada we have listened in some bewilderment to the Governor of the Bank of Canada and the Minister of Finance wailing in harmony over the dangers of inflation under a prevailing buyers' market, mounting unemployment, with not a scarcity in sight. Surely we have reached the point of need for re-assessment of the forces we are faced with. The facts and the traditional theory of how to cope with them no longer seem to make good sense.

37. We seem to have been a bit slow in realizing this in Canada or at least in attempting to do much about it. For some years the United Kingdom has been attempting to break up the pattern of wage increases beyond productivity growth that has been almost automatic or habitual in the expansionist period following the War. In similar habitual fashion businessmen have accepted higher costs, adjusted prices upward accordingly and maintained after-tax profits at traditional levels.

And for this they could scarcely be blamed. Pay pause policy may make some headway in stemming the cost push.

38. More recently in the United States we have seen evidence of determination to attack the price level problem in this realistic way. This is open recognition that the sort of price increases we have witnessed over the past decade, popularly miscalled inflation, has had no relation whatsoever to the money and credit situation and that monetary policy is helpless to prevent this kind of price level increase from taking place.

39. Our purpose in dealing with this subject of price level control which perhaps is merely elaborating the obvious - is to add another voice to those who see no case whatsoever for extending in depth traditional methods of central bank policy, or for introducing what might be called a second layer of controls over businesses which are customers of the chartered banks and subject to chartered bank lending policies. We regard the chartered banks as essentially wholesalers of credit while the second layer of financial institutions are mainly retailers of the same product already created above and dependent on supply from the wholesalers. We believe this generalization to be near enough to the truth to support the conclusion that monetary policy today can fully accomplish that which it is supposed to be able to accomplish by confining its operations to the activities of the chartered banks.

40. We do not, of course, regard central bank policy as by any means the complete answer to the problem of maintaining economic stability and national growth.

Fiscal policy generally can be of some help but it is bound to be slow and fumbly. At best it can do little more than establish a climate. However, governments in Canada have built up a pretty powerful instrument these days in the field of housing. The direct and indirect effects in the business world of policy in this field are pretty impressive. This can be a strong support to monetary policy as such.

BANK OF CANADA RELATIONS WITH BUSINESS COMMUNITY

41. It has been suggested that we might comment on some matters of broader interest, such as general relations of the Bank of Canada with the business and financial community. In presuming to offer any comment whatsoever on this subject we should make it clear at the outset that the issues involved are of little direct concern to our industry and that our interest is mainly that of laymen not particularly sophisticated in these matters.

42. In other sections of our submission we have shown that we depend to some extent on bank loans to accommodate expansion in our lending operations. It would, of course, be helpful to know ahead of time when the chartered banks were going to be less willing to afford the usual accommodation. But clearly our position is once-removed from the direct impact of central bank policy.

43. In recent years there has developed a fairly broad interest in central bank policy. University professors at times come to life on the subject. Parlia-

mentarians now presume to hold views pro and con various fairly esoteric monetary issues and the public generally has shown more concern over broad policies, particularly since politicians have used this subject quite extensively on the public platform. In view of this growing interest in the subject it seems to us it would be helpful if the Bank of Canada were a little less Olympian and inscrutable in their attitude towards the financial community and the business world generally in future than they have been in times past.

44. Quite apart from the question of giving any advance lead on what they are going to do we do think the Bank could do more in keeping the public informed as to why in the immediate past they have followed the policies which they have followed. All too frequently it has happened that financial analysts and writers completely misinterpret Bank policy and invariably these wrong views are never corrected. Misunderstanding continues by default. In our view it is not sufficient that explanation and defence of central bank policies be limited to a few paragraphs in the Annual Report of the Bank of Canada. We think it would be useful if the Bank took more pains today to explain to the public the ways in which they currently attempt to carry out the duties assigned to them by Parliament.

45. As for the claim frequently heard in banking circles that they should have more explicit indication from the Bank as to what near-future policy is going to be we find it difficult to do more than take a middle position on this question. Obviously, as lenders

to the industrial world it would be useful and quite important for the banks to have some indication of what is in store in the near future. A fairly legitimate case can be made by the banks here for more information than in the past has been available to them.

46. However, the chartered banks are not merely lenders to the business community but on a very large scale they are buyers, sellers and holders of government bonds. Closely associated in the financial community are investment dealers. It would, of course, be an intolerable situation if any specialized group of bond dealers were put in a position of having information about future bank credit policies beyond that completely in the hands of the public generally at the same time. This, in very simple terms, we think sums up the dilemma of the Bank of Canada in its relations with the banking system in the matter of giving more indication currently of future policies.

47. It seems to us, however, that this dilemma is more apparent than real and that most of what the banking system desires by way of guidance could be furnished indirectly through closer month-to-month relations with the Bank, perhaps through regular monthly meetings with Bank of Canada officials for discussion of current business conditions and prospects. This would not call for declarations by the Bank regarding its future policies but it would ensure that both sides were aware of each others opinions regarding the conditions on which Bank policies might be predicated. Fortunately such proposed arrangements would be quite

practicable in Canada with only eleven banks to deal with as compared with the banking systems of most other countries where because of the number of banks informal arrangements of the kind suggested would be quite out of the question. "

THE CHAIRMAN: We shall now proceed with our questions.

COMMISSIONER HARROLD: Mr. Chairman, I would like to ask a couple of questions on the functions of the Canadian Consumer Loan Association, as such -- not as to its business, but the Association as a body.

On the first page of your introduction you outline your objectives. What steps does the Association take so that these objectives are carried out? Specifically, I might ask this question: What steps does the Association, as such, take to see that the members carry out its policy calculated to create public confidence in the small loans businesses?

MR. OAKES: Mr. Harrold, we do this by frequent meetings of the board of directors, and also the annual meeting of the Association. We are in touch with our membership at all times. The Small Loans Act, which is the basic legislation of our business, is very specific in its requirements. I think the most important thing is that the members police our own industry and they are always on the alert for any infringement of the act. We are on the alert amongst ourselves. If we feel that any member is not meeting the high ethical standards that we require, then the board of directors has the power to

call that member before them for an explanation; and the final disciplinary action is expulsion from the Association. I can recall only two occasions on which a member has been subject to this action since the Association was formed in 1944.

COMMISSIONER HARROLD: Two members since 1944?

MR. OAKES: Yes.

COMMISSIONER HARROLD: How important is it for the individual company to belong to the Association? Expulsion is a way of disciplining members, but from a selfish point of view, as far as the companies are concerned, what are the disadvantages of not belonging to the Association?

MR. OAKES: We think there are very definite advantages, sir. One of the main advantages is the pool of knowledge and information that is disseminated by the board of directors to the members on such subjects as changes in the legislation. It is a general sounding board for a Commission such as this or any other legislative body, provincial or federal.

All the large companies are members of our Association. You will find that 54 out of the 83 licensees are members, and the non-members are generally companies with very small loan balances, most of them under 500 accounts, and we just feel, as a personal decision, that they are not in the small loans end of the business to the same extent as they may be in the conditional sales business. Of course, some of these people belong to the Federated Council of

Sales Finance Companies.

COMMISSIONER HARROLD: Your objective (a) -- to improve the operating standards of its members -- how does the Association go about achieving that objective? You say, "to improve the operating standards". Could that be described by some of the steps that are taken by the Association -- to disseminate literature, or what?

MR. OAKES: To disseminate information, training programs generally, public relations work, not only disseminating information among the members but also requiring local members to make some effort in their own community to explain exactly the principles behind the industry and legislation. I think, mainly, through discussions at annual meetings of things we believe to be to the advantage of our own industry.

COMMISSIONER HARROLD: Does the Association, as such, arrange meetings with such people as the Superintendent of Insurance or the finance department?

MR. OAKES: Very frequently, sir.

COMMISSIONER HARROLD: As an association?

MR. OAKES: As an association. Most of our contacts, other than for the purpose of an individual problem in a company, are with the Superintendent of Insurance. I suppose I call on Mr. MacGregor five or six times a year to discuss any complaints that have been received. Fortunately, we are always told that there are very few complaints as far as the operation of the act is concerned. We maintain very close contact with the Superintendent.

COMMISSIONER BROWN: What sanctions have you, if any, short of expulsion?

MR. OAKES: If I may just dwell on the one subject of advertising, for instance, Mr. Brown, I have found that the group generally are very co-operative if in the opinion of the board of directors there is some undesirable form of advertising, that we as a group feel is not in the best interests of the industry. Invariably we get full co-operation from our membership in the form of a change in their approach. It has not been necessary in the last five or six years for us to call in any member for disciplinary action.

COMMISSIONER BROWN: You apparently have expelled two?

MR. OAKES: Yes.

COMMISSIONER BROWN: Is there anything short of expulsion, of a punishment nature?

MR. OAKES: No, not of a punishment nature. I think that expulsion from the Association, with the attendant report we would make to the Department of Insurance, certainly would cause the Superintendent of Insurance to carefully consider the renewal of that licence.

COMMISSIONER MACKINTOSH: Could I ask what was the subsequent history of the two whom you expelled?

MR. OAKES: Yes, sir. One company is still in business. The other was a case of over-charging, that is, contravening the rates set out in the Small Loans Act, and the licence was revoked by the

department.

COMMISSIONER MACKINTOSH: The real, ultimate sanction lies with the department in administering the act?

MR. OAKES: Yes, sir.

COMMISSIONER BROWN: It would appear from the brief that approximately half of your applicants for credit are turned down. What happens to them?

MR. OAKES: Like any other lender, sir, it is most gratifying for us to be able to say "Yes"; we like to say "Yes". But you have, I think, a great responsibility as credit granters in ensuring that people do not become overloaded. The 50 per cent usually are people where a loan is not the best solution to their problems. I know, from the time sheets that we keep in the office -- the time a customer enters the office and the time the customer leaves -- in many cases our managers spend more time with people they turn down than with some of the people they make a loan to. When you have people who come to you who obviously need service by some welfare agency, we have, in many cases, referred such people to welfare agencies, where that type of assistance is necessary. But remembering at all times, of course, that the man you turn down today is still a potential customer, and that he may come back. We do our very best to advise these people as to how best to put their financial affairs in order. I think this is of assistance to the applicants. In many cases we can convince the applicant that a loan is not the answer to his problem.

Some of them, I suppose, go to another lender, possibly in our own industry. Two different men having the same set of facts may come up with a different solution. So the individual customer may be turned down by my company and accepted by, say, Mr. Cawker's company. I think that is a matter of professional skill in judging the application. We like to believe that most of these people, when the situation is explained to them, will possibly come back at a later date, when they are better able to take a loan without overloading.

This is a very real responsibility as far as we are concerned. The man wanting the money is naturally anxious to take the loan, and the lender has that responsibility of making an impartial decision.

COMMISSIONER BROWN: Is it possible that these 50 per cent might be reduced by the fact some of them will get loans elsewhere, or some will go elsewhere and just become part of the statistics? Of course, there must be a certain number who do not get any loan at all, and then there are some you refer to welfare agencies?

MR. OAKES: Yes, and some have to tighten their belts and do without.

COMMISSIONER BROWN: Is there any evidence that some of them are getting into the hands of loan sharks?

MR. OAKES: No. Altogether, I think, in the past two years -- possibly because, as I said, our members are always very alert to this loan shark problem --

we have had five or six cases of illegal lending we have referred to the Department of Insurance, to Mr. MacGregor, who has taken immediate action in these cases; and with our membership right across the country it certainly would not escape us if there was any large loan shark operation, as such.

I would like to say, Mr. Brown, regarding these 50 per cent we have turned down, that I would not want to leave the impression these people are all in the low income brackets. In many cases the customer has a good or above-average income, but his other debt liabilities are such that we would not think it wise to advance him a loan. Thus, the 50 per cent is spread right across the whole borrowing application field.

COMMISSIONER BROWN: That saves my asking that question.

On the matter of rates, what proportion are charged the maximum rate -- or are most of them charged the maximum permissible rate?

MR. OAKES: We have what we call a very tight small loans rate in Canada; in fact, with the effective legislation we have, the lowest small loans rate in the world -- certainly lower than any rate in the United States. Because of this we find that the rate is such that most licensees are charging maximum permissible rates.

COMMISSIONER BROWN: In other words, any competition that does exist is not on a rates basis but on a service basis?

MR. OAKES: Yes, on a service basis, and there is very strong competition service-wise. I think it has acted very much to the customers' advantage, this service competition within the industry.

COMMISSIONER BROWN: Is there no real attempt to differentiate between borrowers as far as rates are concerned? In other words a man is either credit-worthy or he is not; and if he is credit-worthy it is the maximum rate -- is this the picture?

MR. OAKES: That is right. Many of the borrowers come to us after applying at other agencies, such as banks, and they are possibly turned down by the banks, and they will apply to us.

COMMISSIONER BROWN: If a would-be customer comes to you who is obviously very credit-worthy do you suggest that he try a bank first?

MR. OAKES: No, sir. There are many reasons. We find, from our practical experience, that the rate is not the sole basis on which a customer will decide whether or not to use our service or the service of another agency. There are many factors involved as far as service is concerned -- the fact we will give them full consideration in the event of temporary unemployment and illness. I think these are some of the things that have developed in the competitive end of our business that have acted to the customers' advantage.

COMMISSIONER BROWN: We notice that a number of sales finance companies have formed subsidiaries in your field; but we do not see much evidence that

people in your field have gone into the sales finance company field, as such. Is there some reason for this? Does your field work in with the other when the other has been established first; or is it that yours is the more profitable end of the business?

MR. CAWKER: I think a very heavy percentage of the licensees shown in the departmental publication, the report of the Superintendent of Insurance, do have associated companies in the sales finance field. This does not apply to the two largest companies in our industry but, generally speaking, I think the percentage would be heavily weighted that we do have associated companies or a company licensed to carry on the conditional sales business.

COMMISSIONER BROWN: It seems they were in the sales finance business first and then went into the consumer loan business, rather than the other way around.

COMMISSIONER MACKINTOSH: It seems that the sales finance companies breed small loans companies, but small loans companies do not breed sales finance companies.

MR. CAWKER: In my own case, I would have to say, no, because it was the other way around; and I think that in quite a few cases this is true. When we speak of the giants in the sales finance and conditional sales fields, I think it has been generally the case that they have gone along side by side. I am not speaking of the history, say, of I.A.C. or Traders, but the larger small loans companies

have a very old history of side-by-side operation with the sales finance companies. I think we all feel, those of us who are in the sales finance field, that a personal loan is an auxiliary service we should be equipped to provide.

COMMISSIONER BROWN: I should like to talk about the loans themselves in a general way now, particularly the question of the number of loans that are renewals and extensions of existing loans. In your brief on page 16, Table 4, you give some figures which purport to answer this problem but I do not think it is quite as clear as the report of the Superintendent of Insurance. On page VI of the Superintendent's report, the table at the bottom of the page shows that of your total loans made in 1960, which was the last year reported, half of them were made to current borrowers with earlier loans un-discharged, and another 17 per cent or so were made to previous borrowers who had fully discharged their earlier loans. Dealing with that first part first where 50 per cent of your new loans are made to people who are increasing their borrowings, is this an indication at all of some people who are getting into debt and cannot get out of debt?

MR. OAKES: No, sir. In many cases a borrower whose credit is good for possibly $1,000 will come to you for a $200 loan for a specific purpose. This loan may be paid down by 50 per cent. Conditions have not changed. The credit-worthiness of the customer would certainly indicate he could handle a $1,000 loan and he would come back to re-finance. Another emergency may come up or he finds need for additional money. These are very basic things as far as this re-finance business is

concerned. People digest a certain amount of their initial debt and then come back. I do not think it is peculiar to our industry. Other lending institutions have the same experience.

COMMISSIONER BROWN: It seems to be a fairly constant ratio in the three years that are shown in the report.

MR. OAKES: Yes, sir.

COMMISSIONER BROWN: Is this historically fairly regular?

MR. OAKES: Yes.

COMMISSIONER BROWN: I wonder if we could also look at Table 5 on page 16 of your brief. The point that strikes one there is the small percentage of loans in the $1,000 to $1,500 category as compared to the ones in lower amounts. Dealing with loans of $1,500 and under, 30 per cent fall in the category of $900 to $1,000 and only 3½ per cent of the total loans up to $1,500 fall in the category of $1,000 to $1,500. Can you give us your ideas as to why this would come about?

MR. OAKES: At the time of the revision of the Small Loans Act in 1956 we took up this point in committee. We felt that the rate between $1,000 and $1,500 was particularly tight in that area when many of our licensees are paying 6 per cent or more for their money. The rate between $1,000 and $1,500 is a simple interest rate of 6 per cent per annum and there is a reluctance on the part of licensees to put money into that

very, very low earning area, yield area. Generally the demand for loans in that area is not as great as in the areas which you have mentioned, sir, below $1,000.

COMMISSIONER BROWN: Well, let us look at the report again which shows the loans above $1,500 as well as those below. This is on page VII of the Superintendent's Report. This shows that of the loans approximately 20 per cent, just under 20 per cent, are in the unregulated large loan category. What would be the average size of these loans? $90 million out of $482 million were large loans.

MR. OAKES: They would be between the $1,500 and $2,000. The average size would be somewhere around $1,700, $1,800 up to $2,000.

COMMISSIONER BROWN: Does it not seem strange that 3½ per cent of the loans are in the category from $1,000 to $1,500, and then you have this much larger grouping between $1,500 and $2,000. You explain that part of this is due to rates but you have also said there is little demand for loans between $1,000 and $1,500. Does it suddenly go up to a larger demand when you get above $1,500?

MR. OAKES: In some cases, yes. You find that in the case of people borrowing in that area it is still generally a consumer-type loan. They are better income people, usually people who have borrowed in smaller amounts. A great number of these customers are either former customers or have had a

smaller loan with us but qualify by credit qualifications for this larger amount.

COMMISSIONER BROWN: Well, if they already have a smaller loan and are extending it above the $1,500 level does not the restriction of the one-half of one per cent a month apply?

MR. OAKES: No, sir. The loan is paid off. Once the existing loan is paid off and a new loan is made in excess of $1,500 then it does not fall within the same category.

COMMISSIONER BROWN: It is a separate transaction?

MR. OAKES: Yes. It is a new transaction, actually.

COMMISSIONER BROWN: What are the rates that you charge on these loans above $1,500?

MR. CAWKER: Mr. Brown, there is a very wide range of rates and, of course, competition is responsible for this. I would say that in the area of $1,500 to $2,500 there can be a renewal of rates all the way from three-quarters of one per cent a month up to one and one-half per cent a month, depending on the risk, let us say, but I do emphasize that competition here as well as in the regulated area is very keen but there is some flexibility available to both the lender and the borrower to negotiate the best going rate, but I would say the range would go from three-quarters of one per cent a month to one and one-half to one and three-quarter per cent a month.

COMMISSIONER BROWN: This would be over the whole amount of the loan?

MR. CAWKER: Yes, sir.

COMMISSIONER BROWN: I may be a little confused on this but I gather from Section 3(1) (b) of the Act that if there was a loan outstanding and you extended above the $1,500 that the one-half of one per cent applied. Do I gather you get around this by doing it in a separate transaction?

MR. OAKES: The loan is paid off and it becomes a new transaction. If it is in excess of $1,500 it would go from the regulated side of the business to the unregulated side. The statistics would then fall into the unregulated group. The loan is actually paid off with the proceeds of a new loan. It is a new transaction.

COMMISSIONER BROWN: What sort of time would elapse between this paying off and a new loan being made?

MR. OAKES: The customer comes to the office for additional money, let us say, which is $1,600 or $1,700. He has a balance of $300 on his old loan. A new loan is agreed upon and the customer's account is paid off. The $300 balance is paid off from the proceeds of the new loan. There are certain provisions in the Act to prevent the splitting of a loan when you have a graduated rate with 2 per cent per month on the first $300. There is a section which definitely prohibits the making of, say, a $300 loan to the husband and a $300 loan to the wife.

In the event of consolidation of two loans of that nature, if the balance exceeded $1,500 then it would fall under the control of the Act and one-half of one per cent would be the maximum permissible rate.

COMMISSIONER BROWN: I am just reading this Act and it says in Section 3 (4):

> "Where a money-lender has made a loan to a borrower and, while any part of the principal balance thereof remains unpaid, makes a loan to that borrower or that borrower's spouse,
>
> (b) if the aggregate of the unpaid principal balances of such loans exceeds fifteen hundred dollars, the total cost of such loans shall not thereafter exceed the cost permitted under this section for a loan of fifteen hundred dollars, plus one-half of one per cent per month on any part of such aggregate in excess of fifteen hundred dollars."

I am puzzled how you get around this by the technicality of paying it off and making a new one.

MR. CAWKER: As Mr. Oakes has said, this is to prevent the making of two loans to one family; in other words, a loan of $1,200 to a husband and of $400 to a wife, making a total of $1,600. Both of those loans would fall under the terms of the Act, and therefore this section would apply. In

the example Mr. Oakes has just given where there is one loan, let us say, with an unpaid balance of $900 and the borrower -- and when I say borrower I am assuming the family -- needs $1,600 you are then permitted to make a $1,600 loan and from the proceeds you pay off the $900 and there is $1,600 loan which then falls outside the provisions of the Act.

THE CHAIRMAN: Where is the provision in the Act that has that effect?

MR. CAWKER: It would be the provision referring to the ceiling.

THE CHAIRMAN: What section is it? Where is the ceiling?

COMMISSIONER BROWN: It is Section 2 (c).

THE CHAIRMAN: Yes, Section 2 (c) which says:

"'loan' means a loan made by a money-lender of not more than fifteen hundred dollars and includes the consideration for a wage assignment; and if, after deducting all payments, whether on account of interest, expenses or principal, made by the borrower to the money-lender at or about the same time as a loan is made, the amount retained by the borrower is fifteen hundred dollars or less, the transaction or transactions shall be deemed to have resulted in a loan of the amount so retained by the borrower notwithstanding

that nominally a loan for a larger
sum has been made;"

I should like to read that a few times before I digest it. What is your interpretation of that? Is it that if the loan is for more than $1,500 the Act does not apply?

MR. OAKES: Yes, sir. The particular wording of that section prevents a situation such as, say, a loan for $1,800 being made with a minimum discount of $350. If the amount of cash received by the borrower is $1,500 or less then this falls into the regulated area of the small loans field. I think that is particularly important in the case of a second mortgage situation.

COMMISSIONER BROWN: The other point in the Act is if it is above $1,500 it is unregulated.

MR. OAKES: Yes, sir, above $1,500.

COMMISSIONER HARROLD: What happens to the interest rate when half of a loan is paid off when the loan is only $700 or $800?

MR. OAKES: What happens to the rate, sir?

COMMISSIONER HARROLD: To the interest rate? It does not change as the loan is paid off and it is reduced to below $1,500?

MR. OAKES: No, there is no change in the interest rate. The interest rate on a loan in excess of $1,500 is generally a rate for the whole amount of the loan.

THE CHAIRMAN: In other words, if the amount of the loan is reduced from time to time so that the

outstanding loan at one point becomes less than $1,500 then the Act does not come into effect?

MR. OAKES: No, sir.

THE CHAIRMAN: To apply to that loan?

MR. OAKES: No, sir. It is the initial amount of the loan which decides whether or not it is in the regulated or unregulated field.

COMMISSIONER MACKINTOSH: I take it the total rate of these loans is a built-up rate, two per cent a month on the amount up to $300 and so much a month for amounts over that?

MR. OAKES: It is a graduated rate. It recognizes the principle that, basically, apart from the cost of money, there are the same costs involved in handling a $300 deal as in handling a $1,000 deal and it gives a preferred rate to the person borrowing the higher amount.

COMMISSIONER MACKINTOSH: I am not questioning that but as the loan is paid off does it proceed throughout its life at the average rate or does it go down the ladder that it climbed up?

MR. OAKES: I would explain that by example, sir. In the case of a person borrowing $1,000 with 2 per cent per annum on the first $300 and one per cent per annum on the remaining $700, the interest is charged on the aggregate of the two per cent and the one per cent. When that loan reaches the $300 point the interest from that point

is charged at 2 per cent a month. In other words, the cheap money is paid off first.

COMMISSIONER HARROLD: That is what I was trying to get at.

COMMISSIONER GIBSON: You do not have a uniform repayment system? In other words, the cost element increases as you go down the scale in re-payments?

MR. OAKES: Yes, sir.

COMMISSIONER BROWN: But it does not decrease when you start above $1,500 and come down?

MR. OAKES: No, it is usually a consistent rate in the unregulated field, sir.

COMMISSIONER BROWN: What is the theory behind this unregulated field above $1,500?

MR. OAKES: If I could take it from the other direction, Mr. Brown, and say what is the reason for a regulated field, the basis of the Small Loans legislation, of course, is to equal out the bargaining powers between the lender and the borrower, particularly in the smaller amounts. We feel that regulation is extremely important in this area, that we must be regulated where people requiring loans of $200 and $300 could well be lacking in bargaining power. We have seen examples of this. Prior to the passage of the Small Loans Act the loan shark business was rampant. You must regulate and supervise the small loans area. However, there comes a point where the borrower should be in a position to bargain with the lender. Initially this was the $500 limit in the Act. It was decided in 1956 that this should be extended to increase

the area of regulation to $1,500. It was felt that beyond that there are many transactions which are deserving of a higher interest rate than that permitted under the Bank Act, not just in the consumer loan field but in the business area generally, and the $1,500 was decided to be the point beyond which the borrower, if he is credit-worthy, should be able to make a better deal with the lender.

COMMISSIONER BROWN: I notice that credit losses are showing a tendency to increase. Have you any comments on this?

MR. MASSON: Well, I think with the increase in the average loan you would also find an increase in your average charge-off.

COMMISSIONER BROWN: I did not get that last word.

MR. MASSON: I say with the increase of your average loan outstanding you would also find an increase in your average charge-off, bad debt.

I think one of the main points in the increased charge-off, where we talk about service and our desire to do the right thing by the borrowing public, I think it is much more the case today in our industry where you find charitable charge-offs where possibly a few years ago they wouldn't be charged off, and for just good social reasons we find it is good business where a family gets into some trouble which obviously is going to create problems, possibly for an unforeseeable time into the future, where the decision is made by the lenders to write off that account. I think there is a more realistic approach to the charge-off today in our industry where there are family problems.

MR. McCLURE: I think the situation is this; that as the demand for cash credit becomes more widely diffused, there are less credit-worthy people applying for loans than when it is highly restricted, and the experience is that as this business matures the charge-off is apt to increase.

In Canada our observation has been that the use of instalment credit is in an accelerating phase, but the demand hasn't become fully mature. Ten or fifteen years ago the charge-off in Canada was very, very low, but now that it is maturing the use of the credit is becoming more a normal practice. There is a more normal type of charge-off, which is that appearing around one per cent of your average receivables, which is beginning to show up in Canada, and I think it is inevitable that the

rate of charge-off in Canada is not only increasing but will continue to increase. There will be fluctuations with the cyclical movement of the economy and the amount of employed and unemployed, but if your experience is anything like it has been below the border, you will have larger charge-offs.

COMMISSIONER MACKINTOSH: I infer the rate of charge-off in the United States would be higher than in Canada?

MR. McCLURE: That has been our experience, sir.

COMMISSIONER GIBSON: Could I return to the question of the people that you turn down, which you say is 50 per cent approximately. You make a point in your brief that your loans are made for often urgent purposes and usually for useful purposes. Now, people that urgently need money are often rather desperate, I would like to know a little more about what happens to this 50 per cent that gets turned down. Do they go to individuals and work out deals? I can't imagine how they all somehow or other are going to cut their budgets to fit the fact they cannot get a loan, because in the past people have been known to pay very high interest rates because they desperately wanted money; what happens to those people?

MR. OAKES: I think the first thing that causes a person to come to a lending agency in order to meet an emergency or some urgent situation, the first desire is the fact that these people want

to be independent, and in a number cases we might turn down a customer who wanted to borrow for a very worthy purpose, such as, "Johnny has to have his tonsils out and I would like to have the money all ready to take care of the doctor's bill," but in going over the family budget -- and we go over the income and family expenses very, very carefully -- we find it just isn't feasible for this man to take $200 and pay $20 a month or the maximum maturity which we can give at the lowest possible payment. There just isn't the money in the family budget to pay it, and we say, "Well, you will have to explain this to your doctor and let him explain it to the hospital." In this case I think they would rather have the money to pay cash, but they make other arrangements. Or, it may be they were reluctant to go to other members of the family and they would prefer to go to a commercial lender initially, but when they find they cannot do that, perhaps there is some help forthcoming from the family, possibly, but I don't believe these people feed any loan shark trade; we are not aware of any loan shark trade to any extent than possibly in a plant where there is a $5 and $10 back pocket situation, and this is our experience, that these people will initially try to be independent, and then they might fall back on other services including their family.

THE CHAIRMAN: As you mentioned before, they might become welfare cases?

MR. OAKES: Yes sir.

COMMISSIONER GIBSON: But you think any loan shark business is confined to small individual transactions?

MR. OAKES: I think so.

MR. MASSON: We find no evidence of it at all.

MR. OAKES: We find out very quickly -- well, imagine with the number of branches we have across the country, if this happens it very soon becomes known in a community and we very soon know about it, our customers tell us about it.

COMMISSIONER GIBSON: Do you think that many of the 50 per cent whom you turn down do not expect to get the money anyhow and are just taking a try at it?

MR. OAKES: There is certainly that aspect of it. We are, in effect, the lenders of last resort; that is the reason that we are given the privilege of license to take care of these people that can't borrow from other agencies, including banks and credit unions, or for some reason that they would prefer outside service.

COMMISSIONER BROWN: And once they are turned down by you there is a stronger argument for the welfare people, too?

MR. OAKES: Yes sir.

COMMISSIONER MACKINTOSH: If they are turned down by one lending agency they apply to two or three more?

MR. OAKES: They may apply to other companies

in our field. For instance, I don't think a man who has been turned down after careful consideration by our industry could walk across to the bank and receive a loan.

COMMISSIONER MACKINTOSH: I mean he has been turned down by some other company in your industry?

MR. OAKES: Yes.

COMMISSIONER MACKINTOSH: And to that extent 50 per cent is double counting?

MR. OAKES: Yes, they may try two or three lenders, but hope springs eternal when they require the money and it may just happen that one lender would make a marginal transaction which possibly a competitor has turned down.

COMMISSIONER BROWN: In the 1960 report of the Superintendent of Insurance he referred to scrip certiciates. You don't mention these in your brief. Has there been any development of this operation?

MR. OAKES: No, sir, this was caught in the incipient stages. We were very concerned about it as an association and made representations to the Department of Insurance, to the Superintendent; we felt that this particular method of financing merchandise contravened the Small Loans Act. Mr. MacGregor felt that way, too.

The mechanics of the scrip operation is that say you have a shopping centre where a potential customer -- you can have a number of merchandising

outlets within the shopping centre or within one large store, and the lending agency will give the people scrip which can be exchanged for merchandise, and the rate was in excess of the Small Loans Act in most of these cases.

Mr. MacGregor interpreted the situation as, in effect, lending money in kind. There were several very bad aspects to this. You could have a situation where the cusomter may obtain, say, $200 worth of scrip today but he may not spend any for a month, but the interest charges on that scrip commence immediately, which bonuses the lender immediately on that one month. The scrip can be lost, but the interest payment on that scrip starts immediately when the scrip is obtained, and he thought it was a very, very bad method of financing merchandise.

COMMISSIONER MACKINTOSH: Was this put out by some agency and controlled by the merchandising outlets?

MR. OAKES: In some cases, sir.

COMMISSIONER BROWN: One last question as far as I am concerned; would you care to express an opinion on the disclosure clause as applied to lending generally, and how the cost of borrowing should be expressed?

MR. OAKES: Yes sir. Of course, you will notice that in our code of ethics -- I think it is Article No. 3 -- we say we feel that the borrower should be fully informed as to the terms and costs of the transaction. We are certainly supporting

the fact that the customer has the right to know the cost of the transaction.

If I may, sir, I would like to show some of the documents that are used in our regulated business. We haven't mentioned full disclosure in our brief because we already give full disclosure in our documents. This is not required by the Small Loans Act, but we feel it is just good business, it is good public relations. At the time that the transaction is made the customer should be fully informed as to exactly how much this will cost. It certainly prevents any arguments at a later date or any bad feeling between the lender and the borrower. This concealment can only result in very, very poor relationships if at some later date the man say, "I was not aware of the cost of the loan". It is Section C of that code of ethics. But having said that, we subscribe to the views expressed yesterday by Mr. Willmott and the other gentlemen representing the Federated Council, and our experience tells us that this is a tremendous problem.

COMMISSIONER GIBSON: Your charges are all expressed in terms of interest rates, are they not?

MR. OAKES: And the actual amount of the loan is shown together with the monthly payment and the amount of the monthly payment.

THE CHAIRMAN: There are no service charges in addition?

MR. OAKES: No, the Small Loans Act rate is an all inclusive per cent per month rate. There are no other charges whatsoever.

THE CHAIRMAN: So that there is nothing further to disclose than the interest charges?

MR. OAKES: No sir.

COMMISSIONER BROWN: Is there anything on these documents to show the basis of computation in case the customer wishes to repay ahead of time? This is covered in the Act. Is there anything in these documents?

MR. OAKES: The customer has full privilege of full repayment at any time without penalty of bonus. For instance, a $100 loan today repaid in 10 days would just be one-third of the $2. The payments are worked to the exact day. There is no provision for minimum charge or acquisition costs.

COMMISSIONER BROWN: Yes, it is in here.

THE CHAIRMAN: Are there many repayments before the due date?

MR. OAKES: Yes.

THE CHAIRMAN: A very large amount?

MR. OAKES: Yes, tremendous. This is not only from the refinancing standpoint, but many customers will take, let us say, a 12-month contract and they believe they need the money for two or three months and say, "Well, in order to be on the safe side I will take it for a longer period; there is no bonus and it doesn't cost me any extra and, in fact, I save money if I pre-pay it." The customers are

very much aware of this, and generally credit users are becoming much more sophisticated.

Now, having said that our documents give full rate disclosure, it is very interesting to find -- and we have made studies of this at our branch office level -- that the customer says, "Well, it is fine; I see the rate here, but how much will it cost me?" The customer asks for the dollar cost.

The reaction of the customer when he comes to our office is (a) he wants the money and (b) how much will it cost me a month; will it fit in with my budget, and we find these people generally have given the prospective borrowing very careful consideration. They like to know the amount in cash, for many of the reasons that Mr. Willmott's group mentioned yesterday; that has been our experience and we think the dollar cost is essential to the customer in measuring it in terms of his own earning capacity.

COMMISSIONER LEMAN: Before we leave this area, there is one question that puzzles me. In the range of above $1,000, $1,000 to $1,500, you are by law not permitted to exceed the rate of one-half of one per cent per month, is that right?

MR. OAKES: Yes.

COMMISSIONER LEMAN: In that same range of credit, that form of credit granted by banks and department stores, et cetera, is there that

6 per cent limit?

MR. OAKES: No sir.

COMMISSIONER LEMAN: Why is that; why did the legislature consider it necessary to impose that limit on your industry in that range and not on others who may be lending in that range, too?

MR. OAKES: Anybody lending cash in that range, sir, would be subject to the Act -- not subject to the Act, but if they were not a licensee they couldn't charge more than an over-all rate of 12 per cent per annum.

You see, the privilege of license is the thing that gives us permission to charge 2 per cent per month on an unpaid balance to $300, and the rest of the rate structure. Any person wishing to make loans below $1,500 that doesn't have a license, is by law restricted to 12 per cent per annum maximum charge. This, of course, doesn't apply to financing of merchandise.

COMMISSIONER BROWN: Your rate works out to just about a little over 12 per cent per year on $1,500?

MR. OAKES: It is 15¼ per cent, sir, on $1,500 at a graduated rate.

COMMISSIONER LEMAN: Do you subscribe to the aims of this, that it does apply to cash loans and not to loans for the purchase of goods?

MR. OAKES: We certainly believe that regulation must apply to that type of loan which we term a small loan. There are many other aspects and constitutional problems as far as merchandising is concerned; there are property and civil rights. I am not a lawyer, but having discussed this with lawyers I know that the problems in that area are tremendous.

In our own industry, and I think in the merchandising industry, with the exception of a very small fringe group, I believe that the rates are competitive and fair.

There have been some very bad examples used against some of our retail stores, for instance. They had to do with the smaller type of contract where because of the initial cost and the small amount of money the minimum cost will come out at a considerable interest rate. But, we know it is absolutely impossible to even investigate an application for that minimum charge. If you want to relate it to the service you can say that it is 54 per cent per annum. If this has any psychological effect on the customer -- I suppose he is happy to obtain the credit, but it is slightly marred by the fact that it is 54 per cent. That charge of $2 would in no way compensate the credit grantor for the work that must be done to put that account

on his books.

COMMISSIONER GIBSON: With reference to the total charge which the sales finance companies emphasize as the important figure I was just looking over these forms, and I do not see a place for that. It is clear in all of them as to what the rates of interest are, but you do not have a place where you show the amount of loan and the total money charge; is that correct?

MR. OAKES: There is a place which shows the total amount of principal, sir, and then you will find that it is repayable in X number of monthly instalments.

COMMISSIONER GIBSON: It needs some multiplication to get the figure I am talking about.

MR. OAKES: Yes, but it is fairly simple multiplication.

COMMISSIONER GIBSON: Yes, it is, but I do not find it on the form in that particular way.

MR. OAKES: In any particular transaction the charts in our office are discussed with the customer. He sees the amount of his monthly payments, and, as I say, this is very important to the customer. He has to know whether he can afford the monthly payment. The managers who explain the transaction are required -- and this is general throughout the industry -- are required to explain the dollar cost and the interest rate, but we have found that primarily the customer wants to know how much

it is in dollars.

COMMISSIONER GIBSON: I have one other question. I am sorry to keep going back to the 50 per cent who did not get a loan, but can I ask, Mr. McClure, whether that is the typical American experience?

MR. McCLURE: It varies, Mr. Gibson, with the prosperity of the cycle in which we happen to be. There are times when we may be able to lend to 60 per cent of our new applicants, and there are other times when we will fall to 40 per cent of the new applicants. I think this figure of 50 per cent may be the Canadian experience, or it may be the average which dramatizes the fact that loans are not obtainable by all new applicants. Yes, the experience here is not only typical with what we have in the United States, but it has been true for a business generation, to my knowledge.

You see, we are doing business with a parade of people, only a minority of whom have a need for this service. This is not like cigarettes or gum -- perhaps you can think of a better illustration -- where it is conceivable to assume that everybody may be using the product. This is not designed for everybody. This is a remedial service designed for only that minority in the group that has a financial emergency.

The problem is how to advise that minority that when the need arises they should come to your institution rather than go to a competing institution

within the same area, or to an institution which competes with our own group. The only way we know of doing that is to advertise, and you have to advertise in such a way as to not turn away, or to bother, the people who do not want to use your service. You have to put up just a sign, which, in effect, says in the most convincing way you know: "When you need the money come to this particular institution." Now, advertising pulls in the good, the bad and the indifferent, so you have to make a selection because you are in the business of getting your money back. You cannot lend to every Tom, Dick and Harry who comes in. Your advertising pulls in the good and the bad, as I say, and you have to weed them out.

In many cases, perhaps, you may see that their needs may also be postponed. They think they need something today because they are unschooled in handling financial affairs or in discipline, and they can be persuaded to wait. So, it is not a question of having a loan today. Many of these 50 per cent who are turned down are handled in such a way, if the lender is able to do it, that at a later date they will come back when their need is right for the lender to grant a loan, or when that borrower's position is more secure.

The advertising brings in people who have recently moved, or who are unstable, people who change their jobs and their residences often. There is no evidence that their promise to pay can

be relied upon. That is where the selection of the borrower comes in. So, on new loans that experience is normal.

COMMISSIONER BROWN: There is one point here that I omitted to cover, but which I intended to. I notice that the number of new loans in the small loan field that have been made each year has been pretty constant for the last three years at $280 million, but the outstanding year-end balances have been going up by between $35 million and $40 million each year. What does this indicate?

MR. OAKES: It indicates basically an increasing average balance. Of course, the new money advanced has been consistent, and I think that Mr. McClure explains it very well when he says that the new money has remained at a remarkably uniform level each year. The continued expansion of the credit union movement and the greatly expanded activities of the chartered banks in the field of personal loans have undoubtedly had some effect on this trend. The borrowers who re-finance loans and people who have borrowed before have one advantage over this group that Mr. McClure has just described. These people have established a credit rating with you. In most cases they have proved that they are able and willing to re-pay the loans. They have stability and all the other credit qualifications.

Then, you have the initial customer who

borrows $200 who will come back a year later, possibly, and then borrow $400. It is well within his ability to repay that loan, and therefore it increases the average balance of his loan. This represents the increases in the outstandings that you have mentioned.

COMMISSIONER BROWN: Does this mean that the average term is lengthening?

MR. OAKES: No, terms are again controlled by the Act. It means that the borrowers individually are establishing their credit, and taking larger amounts of cash credit.

COMMISSIONER BROWN: Well, your amounts loaned to new borrowers are not showing any increase over this period, but the number of branches has been increased by almost 20 per cent. Does that indicate that your new branches are just running to a standstill, or something?

MR. OAKES: No, sir, it indicates that in order to maintain that level of new borrowers we must continue to offer our services to new areas that we have not been servicing. In the case of cities like Ottawa it becomes convenient to break up existing branches in order to give good service to the customer -- to break up those larger units into smaller ones. As a unit grows we have to break it down into smaller units in order to give better service.

COMMISSIONER BROWN: Those are all the questions I have, Mr. Chairman.

THE CHAIRMAN: You have mentioned consolidation of debts, and apparently nearly a third of your borrowers give that as their reason for borrowing. Can you say generally what effect these consolidations have? They would, I suggest, be for the purpose of rolling all debts into one and then increasing the term. Would that be so?

MR. OAKES: It is, in effect, a safety valve in many cases. The consolidation of debts is the main and principal purpose given for that loan. There may be some ancillary reason, but this is the main purpose. It may come at a time when a man has just returned to work from temporary unemployment, or there has been some unexpected family expense, or a reduction in income. We have found that the levelling off period in our economic activity, when many people are not working over-time and their income is reducing, makes these people use the consolidation service as a safety valve in order to retrench, as it were, and handle their debts in an orderly fashion.

THE CHAIRMAN: In most of those cases would they owe money in some definite way such as by promissory note or borrowing from some institution, or would it be just money they might owe for groceries, or something of that kind?

MR. OAKES: It is a mixture of all those creditors, sir. It is very hard to say any one main purpose. Would you have anything to say on

that, Mr. Cawker or Mr. Masson?

MR. MASSON: I think Mr. Chairman, consolidation of debts generally runs down to housekeeping debts or trade debts within the home.

THE CHAIRMAN: That is, perhaps, a debt on which they are not paying any interest at all.

MR. MASSON: Yes, but they find that there is human frailty involved in meeting obligations that are not creating a disciplinary influence on them. They are just not meeting those expenses out of the family pay-cheque, and it is much easier to consolidate these debts and owe money to a company that is going to insist upon their paying. They find it is a disciplinary situation to which they like to adhere. I suppose it is like buying insurance. If we were all intelligent and very smart we could take the money that we spend on insurance, invest it wisely and possibly get a greater return than an insurance policy gives us, but the discipline imposed by the conditions of an insurance policy, in having to pay the premiums every month or every year, makes it much easier than trying to do it on a hit or miss basis.

THE CHAIRMAN: Does the demand for consolidation of debts tend to increase in times of unemployment or of tight financial conditions?

MR. MASSON: No. I think, Mr. Chairman, that the members of the public govern this themselves. In this business I think it is natural that in times of good employment or good

wages people tend to take on responsibilities that they would not take on when the economic clouds are darker.

THE CHAIRMAN: So that your business tends to increase during good times and to decrease during poorer times?

MR. OAKES: Yes, but it does not follow the business cycle to the same extent as in the case of durable goods. However, that is the trend; it tends to improve with good times.

THE CHAIRMAN: Have you given any figures in your brief that indicate that? I do not recall any specific reference to that situation.

MR. OAKES: No, I do not think we have given any specific indication in the brief with respect to that situation, but it is certainly an experience that I know this group can confirm.

COMMISSIONER GIBSON: Your loans and assets seem to go up every year.

MR. OAKES: Yes.

COMMISSIONER GIBSON: Despite the slight recessions we have had during this period the figures have been going up.

MR. OAKES: Yes, new family units are coming into the market more and more. Our type of service and other institutions, I think, have helped to sell the idea of instalment purchasing and instalment borrowing, and they have served to increase public confidence in the whole field.

MR. McCLURE: Might I say in response

to Mr. Gibson's question that I think the cycle within the area that Mr. Masson and Mr. Oakes have spoken about has been marked by the tremendous over-all growth in this type of business, not only for our industry but for all consumer lending businesses in the last ten years. Therefore, it is true that each year your Canadian figures show an increase and yet the demand will vary at the branch office level in the flow of applications.

MR. MASSON: I think, Mr. Chairman, this is very general in areas that are dominated by one large industry. For instance, in Windsor, Oshawa and now Oakville, where you have a large number of automobile plants, when those plants go on strike or are shut down not only does this particular industry,but all consumer-serving industries,have a natural set-back. This has been brought out, as I say, in Windsor and Oshawa in years gone by. The most dramatic illustration in recent years was when the workers at the Ford plant at Oakville went on strike. That Christmas was the worst one that had ever been experienced in that town. People just stopped spending money as soon as the smoke stopped coming out of the Ford plant's chimneys.

THE CHAIRMAN: Would you have a greater demand for loans?

MR. MASSON: No.

THE CHAIRMAN: I was just wondering whether the demand was greater, but there were fewer loans that you would approve?

MR. MASSON; No, the demand was just not there. As I said before, this is governed by the people themselves.

THE CHAIRMAN: We shall adjourn for 10 minutes.

--- A short recess.

THE CHAIRMAN: We shall now resume.

I think it has been mentioned already that all the regulated loans are made at the maximum permissible rate. That is so?

MR. OAKES: Yes, sir.

THE CHAIRMAN: In view of that, what steps do you take when you incur increased expenses? You are in a position where you have not much flexibility, and you cannot increase your revenue, except, I suppose, by increasing the number of loans outstanding; but, nevertheless, there are costs incurred in the increase. How do you improve your net position financially?

MR. OAKES: We are constantly striving for more efficiency, sir. With the fixed ceiling and the floor coming up, as it were, we have to concentrate on this at all times.

There are ways in which you can improve your net position. Our business is one that requires a substantial leverage factor -- volume, certainly. We find that some of the smaller licensees have pulled back on their small loans operations where they have not been able to develop, on a local basis, the volume that is required, and they have concentrated more in the field of larger loans or conditional sales contracts. This is a very real problem when you are not in a position to pass on substantial increase in salaries, rentals and all the other factors, to the consumer.

THE CHAIRMAN: There are figures in the

brief showing what the write-offs are. I do not know that it is necessary to pursue that. To what extent can you control the credit losses by making variations in the quality of loans made? Is the quality improvement a matter of making smaller loans per customer, or reducing loans to certain customers? Perhaps we could have a picture of the manner in which you deal with this situation.

MR. OAKES: The main method of dealing with it is up-grading of the credit risk. We do feel we have a responsibility in the area of, particularly, the small necessitous borrower. We are licensed for this purpose to take care of as many of those people as we can; but, generally, in order to control losses it is a matter of close control in handling over-due accounts and making new arrangements with customers. Mainly, it is the up-grading of the credit qualifications.

We are very sensitive to the geographical situations. I remember well the Elliot Lake situation, where a number of our members were operating in that town. We certainly had to pay a great deal of attention to what we knew would be the ultimate situation, with many people moving out of the area.

I think that control of accounts on a close personal basis and up-grading of credit risks help to keep that write-off figure within bounds.

COMMISSIONER MACKINTOSH: I would like, Mr. Chairman, to try to get a clearer picture of the

industry's sources of funds.

I look at tables 22 and 23 in the appendices, headed, "Analysis of Funds of Consolidated Parents of Nine Licensed Companies". Does this mean that those licensed companies do not do their own financing and that it is done by the parent company?

MR. OAKES: The situation generally there is that the parents do the fund-raising -- the parents raise the funds for their affiliated or subsidiary companies.

COMMISSIONER MACKINTOSH: Then the figures given here, are they only for the Canadian subsidiary or are they all the funds that the parent companies raise?

MR. OAKES: They represent all the funds that the parents raise, sir.

COMMISSIONER MACKINTOSH: There is nothing then to indicate how the parents dole it out among the children?

MR. OAKES: No, it is very difficult to arrive at that figure on an industry basis. We are trying to present our figures as an association.

To give an individual example of one of three foreign-controlled companies, possibly Mr. McClure would have something to say on the fund-raising by a particular company.

MR. McCLURE: Mr. Commissioner, is your question: How does the parent decide how to dole the funds out to the children?

COMMISSIONER MACKINTOSH: Yes, that is it.

MR. McCLURE: I would say that a foreign parent of a Canadian-operated small loans company, once committed to operation in this country, sees a field which is fertile for supplying this type of demand, an opportunity profitably to employ their funds in this type of business; and, therefore, there is a rather uninhibited desire to supply the child with the funds. One of the things which could dampen that enthusiasm would be if they could only acquire a certain amount of funds and if they could employ it more profitably in Timbuctoo than Canada, they might favour Timbuctoo. However, as far as I know that has not been the case, and there has been this uninhibited desire to finance the Canadian operation.

COMMISSIONER MACKINTOSH: I was interested more in what inhibition there would be in periods when money got tight in both countries.

MR. McCLURE: Well, if it was so tight that the parent could not acquire enough funds to supply both, then there would have to be a decision made; there is no question about that.

Would your question then go beyond that to: Has such a situation arisen?

COMMISSIONER MACKINTOSH: Yes, I would be prepared to go that far.

MR. McCLURE: I do not want to anticipate your question, but I would say that we are talking about a relatively short period because I think most of the American companies have not been operating

up here prior to 1933 -- give and take a couple of years. I would say that during that period there has never been any inability on the part of the American parent to finance the Canadian subsidiary, either with funds raised in Canada or funds obtained in the United States and sent across the line.

COMMISSIONER MACKINTOSH: Other people who have appeared before us have indicated that there have been several episodes of tight money in that stretch of years. Does it not affect your industry?

MR. McCLURE: Yes, it does, and I can only speak in response to your question to my knowledge. There may be some American-based companies which have not been able to supply their Canadian subsidiaries, but I do not think that is the majority experience up to this time, sir.

MR. OAKES: For the Canadian companies, Mr. Commissioner, of course, the effect of tight money falls very heavily on the smaller companies, companies that do not go to the public and who possibly do not deal in the commercial paper market or use other forms that are dependent to a large extent on bank credit. Certainly, those companies are affected.

As we spoke of the problem of ceiling in the regulated field, we have to be very conscious of the amount we pay for our raw material, and the control of this cost is very important, to the point that I am sure there may be a going interest rate at which we would decide to up-grade or curtail our credit to a certain extent if things reached that

stage.

COMMISSIONER MACKINTOSH: Over the past 10 or 15 years have there been any marked shifts in the sources of your funds, or do they follow a pretty consistent pattern, speaking, say, now of the Canadian affiliates?

MR. OAKES: I think one of the main shifts has been for the companies to move away from bank lending to a certain extent, and to seek out other sources of funds.

As the receivables of a company mature there is a funding from short-term into long-term debt, as you see the operation grow, and this is a very logical movement.

COMMISSIONER MACKINTOSH: Is that because the average term of your lending has been extended?

MR. OAKES: The demand. Usually, sir, starting from scratch you build up a demand and possibly you are using short-term financing. As that demand increases your loan account is consolidating. We have shown, through some years, marked increases. In recent years the increase has slowed down. As this is consolidated you simply move into the longer-term debt structure, where possible.

COMMISSIONER MACKINTOSH: This is because you develop a dependable fraction of business you can afford to cover by long-term borrowing?

MR. OAKES: Yes.

COMMISSIONER MACKINTOSH: As against the fluctuating fraction which, presumably, is needed to

be covered by a shorter-term borrowing. Is that the logic of it?

MR. OAKES: Yes, that is substantially so.

MR. McCLURE: Fundamentally we employ our assets long-term. We do not expect or want them to decline, the assets employed in the business. Primarily we are talking about assets invested in customer notes receivable. If those assets are represented on the liability side by short-term borrowing you are carrying more than the normal business risk, because every time a short-term note matures you have to re-negotiate the interest rate and the term, and you face the possibility you may not be able to get it. Therefore, it is risky to employ long-term and borrow short-term. So, as a company gets started, they start out short-term in order to avoid this temporary shift, the little cycle. Then, as soon as they can, they can have enough short-term funds of a size which economically warrants re-funding into long-term. Then they should have their heads examined if they do not, because if you have long-term liability you are much safer in employing your assets long-term. So the ideal is to have as much of your long-term liabilities represented by long-term assets as you can. But you make that progress one step at a time. You start out all short-term and then take one step forward with long-term, and eventually a company that has been doing this for some length of time would have $4 or $5 long-term for every $1 on short-term. That is the philosophy

behind it.

Of course, there are other reasons. Right now there is also the reason that short-term money is more expensive than long-term; but that is a temporary situation.

COMMISSIONER MACKINTOSH: When you say that your commitments are predominantly long-term, how long is the long-term?

MR. McCLURE: That requires elaboration. You can measure the length of our assets -- that is, our customer notes receivable--by the length of contract which they sign --

COMMISSIONER MACKINTOSH: That normally runs up to what -- 24 months?

MR. McCLURE: Let us say, on the average, 20 to 24 months -- the speed with which they refund, and that would perhaps fall in the neighbourhood of 10 months, and the length of time that they are on the books, regardless of the number of contracts they have, and on average that would probably fall for a mature company somewhere between 23 and 28 months.

That will give you an idea of the length of our contracts. But, you see, the lenders are in business to continue to be in business so when I said we employ long term I am not speaking about the length of time we invest in the assets of the customer notes receivable from the point of view of the customer but how long we intend to have a body of receivables outstanding regardless of who the customers are. Does that answer the question?

COMMISSIONER MACKINTOSH: Yes, it outlines at greater length what I said when I said you developed a dependable volume of business.

MR. McCLURE: You are right, sir.

COMMISSIONER MACKINTOSH: And therefore it is safe to get into longer term financing. There were a couple of sentences or short paragraphs in your brief which I did not quite understand. I would refer you to paragraph 77 on page 30, which reads:

> " One foreign-controlled company, due to indenture restrictions on the parent, can borrow only from affiliates. The parent company has several times attempted to sell large quantities of Canadian dollar securities to Canadian institutions but has not been able to do so to the extent desired and has found it necessary to sell these same Canadian dollar securities to institutions and others outside of Canada."

Would you explain that more fully? It does not state much more there than this company had difficulty.

MR. McCLURE: May I answer that, Mr. Commissioner? Many companies which are in the business of borrowing large sums of money do so not on just a plain promissory note but on a promissory note secured by a formal document, an indenture, which among other things includes what are known as negative covenants. One of the negative covenants which is usually required by creditors is that the equity of the parent company in its subsidiaries shall not be diminished by permitting the subsidiaries themselves to borrow money from third parties. It is the old abuse of the Holding Companies Act which arose in the twenties and resulted in a great deal of grief. That negative covenant usually takes the form of limiting the parents' subsidiaries in the amount of money which the subsidiaries can borrow from third parties. Sometimes it is a prohibition and sometimes it is a limitation, but it is such a limitation that many of the subsidiaries of parents are not able to borrow any substantial amounts from third parties. That is what that refers to. That means that if the subsidiary is to grow it has to grow only by advances from the parent and those advances from the parent come in the form of investment in the stock, drawback of earnings, and direct loans. Have I covered the question?

COMMISSIONER MACKINTOSH: Yes, so far, but it goes on to say that they have attempted to sell Canadian dollar securities to Canadian institutions

but have not been able to do so.

MR. McCLURE: When you have a business operating in two currencies you run a hazard of an exchange loss when you make advances from the parent to the subsidiary across the exchange line. You eliminate that exchange hazard to the extent that the parent company can borrow money in the currency of the operating subsidiary. Some of the companies have found that the amount of the Canadian dollar investment available for the American parent is inadequate for the demands of the subsidiary. In other words, they cannot get enough money and that is all that this says, that this particular company made an effort to sell the parent company Canadian dollar bonds to Canadian institutions in Canada, and at the same time to American investors who are willing to buy Canadian dollars and invest them for the sake of the higher interest rate.

COMMISSIONER MACKINTOSH: Then it is just that the Canadian investment market is not sufficiently enthusiastic about these securities to take as much money as the parent company would like to market. There is no special obstacle there.

MR. McCLURE: No, nothing but the voluntary decision of the investment market. You are quite right.

COMMISSIONER MACKINTOSH: I had thought there was probably some difficulty about withholding tax.

MR. McCLURE: That may play on the enthusiasm of the investor but it is not a prohibition.

COMMISSIONER MACKINTOSH: It has on some occasion a marked effect on enthusiasm.

MR.McCLURE: Yes.

COMMISSIONER MACKINTOSH: I have another question which is of a different kind. Do the companies in your organization to any degree pool their credit investigations or do they all operate independently?

MR. OAKES: The credit investigation of the individual applicant, sir?

COMMISSIONER MACKINTOSH: Yes.

MR. OAKES: No, each company does its own credit investigation. Of course, the credit requirements do fall into a pattern. I think there has been a big improvement in the general situation. In recent years the members of our Association have formed lenders exchanges in the larger centres such as Toronto, Vancouver, Ottawa and so on, where we have imposed a restriction upon ourselves as lenders. An applicant would come to one office and that company would clear through the lenders exchange where all loans made by Association members in that area would be registered in order that we can insure that people are not borrowing from three, four or five sources, and we restrict that to two loans.

COMMISSIONER MACKINTOSH: You restrict that to?

MR. OAKES: A customer may have, within his ability to pay and his credit requirements, a loan with my company and a loan with one other company. That is the self-imposed limit.

COMMISSIONER MACKINTOSH: It is much more liberal than the one bank rule.

COMMISSIONER LEMAN: In that section about the sources of funds I notice another paragraph, paragraph 79, which reads:

> " A large foreign-controlled company whose officers are in Canada informed us that in their opinion the officers of their company were better able to sell privately the company's obligations than were investment dealers, although they did obtain some information from dealers."

It is said that this is the opinion of one foreign-controlled company, but what does the industry as a whole feel about this matter?

MR. CAWKER: I do not think that view is shared by the industry as a whole.

COMMISSIONER LEMAN: Do you think that company was referring just to availability or to the cost involved?

MR. CAWKER: Probably availability rather than cost.

COMMISSIONER LEMAN: So in effect you do not share this view. Is there anything more on this section, Mr. Chairman?

THE CHAIRMAN: No.

COMMISSIONER LEMAN: If there is nothing more in that section I should like to turn now to another subject and that is the question of control, on which the brief itself did not make much of a case,

but on which Dr. Eaton has put in a special paper. Dr. Eaton at the beginning of his paper says that his submission, instead of being just descriptive, as most of the main brief is, is analytical and argumentative. May I invite you, Dr. Eaton, to continue to argue this case but keeping in mind, however, that the Commission does not necessarily want to argue with you or your clients about the points you make, but for purposes of clarifying our own thoughts we would like to ask you some questions on this.

Certainly looking at our terms of reference I do not think this Commission is interested in looking into any of the moral or social aspects of the various economic activities that go on in the country, so that I do not think we would like to argue about the question you raise in paragraph 9 that no one should make absolute judgment as to whether the consumer credit is too high or is used too much for the good of the people, but we might be interested in thinking about it in the terms of the effectiveness of monetary control.

You make a point in your paper about the purpose for which the loan is used. You seem to argue from that that if a loan can be considered non-inflationary there is no case for trying to restrict its use. Do you really believe that loans are by their nature inflationary or non-inflationary?

DR. EATON: Generally, yes, I think so. In saying that I have in mind that generally in the banking system there may be changes from normal increases

in loans mostly to business, or decreases. That is the main field in which any expansion of loans, money supply and loans, finds its expression. That is where it works itself out, whereas the type of loans I have mentioned here as not being inflationary are more in the nature of just ordinary spending, ordinary necessitous cases that do not expand or contract generally in periods when credit generally is expanding or contracting.

I would not like to say that just the fact of loans being made is mainly responsible for what you might call the inflationary forces. It is the spending of them. It is perhaps a small point of difference but it is the spending of money and crowding of spending it which causes inflation rather than the existence of the loan itself. It is a small point but I think it is fair enough to point to the spending as the cause of inflation rather than the fact of the loans outstanding.

COMMISSIONER LEMAN: Are you suggesting that the monetary authority in looking at the conditions it must look at to decide on a certain action should right off the bat be a little selective in considering the effects of the action it is going to take?

DR. EATON: Yes, I think that is correct. I think what I am saying is that mainly it is the banking system that is responsible for the main flow of loans to industry, and that is the direction that should be watched. I think I have used the word "selective" in the sense that these types of loans that people are making are not really in the picture at all. They are not large and they are of the sort which I suggest

here should not be interfered with, for generally that is not the kind of spending which expands and contracts and may cause inflationary forces to get under way. It is selective in that sense, yes.

COMMISSIONER LEMAN: In that same sense, though, what is the meaning of these particular words in paragraph 62 of the main brief:

> " Such loans should be fostered in times of economic change and stress because at such times need for them increases."

What are the type of conditions in the economy that are referred to there by the words, "economic change and stress"?

MR. OAKES: One of the main stresses is increase in unemployment, or at the end of the cycle when things get underway the increase in employment, where people wish to pick up the commitments which have accumulated during a period of temporary unemployment. Then there is the re-adjustment of family living standards. There are the social aspects. We have been concerned with the number of people that are turned down. What happens to them? From the social aspect we feel that money should be available for these remedial purposes, and that they give the smaller borrower the opportunity to retrench and re-adjust, possibly, his living standards or living costs.

COMMISSIONER LEMAN: So, you were referring to the situation of a particular individual and you were not talking about the general conditions of boom

or recession in the entire economy?

MR. OAKES: No, sir, I am speaking purely from our experience as operating people dealing with the public, knowing the reasons and the circumstances of their requirements for money, purely and simply the social aspect that money should be available for these purposes. Even in times of tight money or of easy money, family emergencies and these situations arise with just about actuarial regularity. We examine the family unit, and that is the situation I am speaking of, Mr. Leman.

COMMISSIONER LEMAN: To get back to Dr. Eaton's argument, would you not say that what the monetary authority would be looking at mostly would be whether more or less use of credit in the economy leads to more or less total expenditure for goods and services?

DR. EATON: Yes, I suppose so.

COMMISSIONER LEMAN: And these loans for the purposes you have described may still lead to more total expenditure for goods and services than if they were not made?

DR. EATON: Some, yes. I think I would have to agree with that. Just go through the list. Take consolidation of debts. I would say no to that. You could not argue very well that there is an increase upon that. One man borrows here and pays off there. It is a passing around of credit. Take travel. I suppose you would say that is spending for goods and services. It is moving around. Take sickness, paying

off your doctor and paying taxes and paying your insurance. I suppose some of these are payments for goods, certainly for services. As I recall it, a large item is automobiles. Take second-hand cars. That is just passing around that which is in existence. You find your car lots chockfull of second-hand cars and a fellow borrows and buys one. I do not know that you would say that is directly and immediately the result of purchase of more goods in the sense of getting them to be produced. It is just a shuffling around of existing goods, which does not directly lead to more process of production.

COMMISSIONER MACKINTOSH: Still, at that phase of the business cycle when monetary policies might be concerned with consumer and other expenditures which were rising rapidly, is there any reason why the used car dealer, the doctor, the various people whom your industries customarily deal with shouldn't be pinched a little along with all the rest of the community? The pinch doesn't fall particularly on the man that borrows from you, it falls on the fellow whom he can't pay unless he gets a loan from you; they are the fellows that have to curtail their expenditures?

MR. CAWKER: I think, Dr. Mackintosh, that probably it is worthwhile considering one statistic on page 19, table 9; 71 per cent of our loans are made to people between the outside age limits of 20 to 44.

Now, we as a group have a pretty high opinion of the ability of the Canadian consumer to manage his affairs, but I suppose probably it would also be fair to say that in the family group, in this lower age limit, they might be capable of making a few more mistakes than the category, let us say, from 35 or 40 on up.

When, as Dr. Eaton has suggested, the banking system curtails loans to industry, there is hardship already in the curtailment of profits, but I think when you curtail the ability of the small necessitous borrower and getting the problem of, let us say, a rather large portfolio of debt off

his back by means of consolidation, that there is a parallel here, too; that the heaviest percentage of our loans are made for consolidation, and in the ultimate projection the money does get back into circulation possibly through the merchant or through the doctor, or whoever is paid by this consolidation. Still, there is hardship in the one case if there is control and probably a curtailment of profit and slow-down of the flow of funds in the other example that has been given by Dr. Eaton.

COMMISSIONER MACKINTOSH: I was just trying to whittle off the compassionate rind that had been put on this.

MR. OAKES: Compassion exists more with our customers and consumers than it does with the man who will be paid. We are trying to solve the problem of the individual.

COMMISSIONER MACKINTOSH: There are compassionate cases here, but they attempt to say it has no effect on expenditures and I think that goes a little too far. Now, the effect may be so fractional that it is not important; I am not arguing that.

COMMISSIONER GIBSON: But it does put more liquidity into the system when you allow somebody to pay who wasn't able to pay before, and this is characteristic of loans from most financial institutions; they make somebody more liquid.

DR. EATON: I think I would agree a little bit and I would like to resist a little bit.

COMMISSIONER GIBSON: This is how monetary policy works, is it not, on the marginal cases?

DR. EATON: Yes, but there are marginals and marginals, and I think I would say in volume particularly.

COMMISSIONER GIBSON: You are almost saying, Dr. Eaton -- correct me if I am wrong -- that the level of consumption isn't a very significant factor from the standpoint of the monetary authorities; is that a fair statement?

DR. EATON: No, I don't think it is. I think it works down indirectly. I would say from the point of view of the monetary authorities that it is the loans to business which are the big factor in the ups and downs here of the credit and of potential inflation, and it is secondary that it will work its way down into consumption. Obviously a man will not go ahead if he can't get credit and there will not be as many people employed in that plant as otherwise would, and downstairs you would see that there will be less consumption. I think it is a bit out of proportion to look downstairs at the minor bits of consumption financed by these loans and say this is significant in the control of the system. I think that is essentially what I am saying.

COMMISSIONER GIBSON: The funds for business purposes are very important from a monetary point of view, particularly inventory?

DR. EATON: Yes, they certainly are.

COMMISSIONER GIBSON: And for investment purposes, but there are times when the level of consumption tends to rise rather rapidly, too, and in this country and in other countries there has been concern about these waves of consumption expenditures, particularly in certain areas. Concern has been expressed in this country in recent years about our balance of payments; we are living higher than we should. This view has been expressed in Great Britain a good many times, and they ended up by trying in one way and another to restrict consumption as well as investment, and I just am wondering what you think of this line?

DR. EATON: Well, I think in this period, take the last 10 years -- and you might take out 1956 -- you might argue that the consumption factor downstairs was relatively important.

COMMISSIONER GIBSON: Why is it downstairs, why isn't it all on the same floor?

DR. EATON: Well, perhaps I will come at this another way. I do think that in almost no other year has there been anything that might be called an inflationary factor as a result of consumption.

Now, take the middle of 1956, I am not sure -- we don't know how anybody can be very sure what happened in 1956 -- but take about the middle of 1956, along about June and July of 1956, prices started going up and it was quite striking in that year. Now, I don't know what is responsible for that,

whether it was a cost-push accumulating or consumption creating scarcities which started prices going up, but I don't know of any other year in this decade where it could be said that it was consumer expenditure that was pushing prices. That is what I am getting at in saying that consumption at this level should not be regarded as in any sense inflationary at any time.

COMMISSIONER MACKINTOSH: Would your argument extend to the sales finance industry?

DR. EATON: Oh no, I think not. I don't know too much about their business, but I believe a lot of it is financing purchases and ---

COMMISSIONER MACINTOSH: Suppose that in 1966 you had a repetition of the 1956 experience and it was felt desirable by some means to put the brakes on a bit on the sales finance companies, how far would the consumer loan companies take up some of the bulge?

DR. EATON: Oh, not much, I don't think so. I think essentially I am saying that I don't think in any case controls should be attempted down that far.

COMMISSIONER MACKINTOSH: Well, that as I understand it is one argument, but you do make the argument -- if I remember correctly -- that whether desirable or not they are impractical?

DR. EATON: Well, I don't think that many -- I am guessing and perhaps I had better let some of the others talk about this, but there would be

many customers shift from the purchase of new cars if they couldn't be accommodated by finance companies; they would come to us and borrow, but I don't know how much of that you would expect.

MR. CAWKER: In 1960, Dr. Mackintosh, the purchase of automobiles -- and we don't have a breakdown as whether they were new or used -- represented 11.08 per cent of the purpose of the total loans made. I do know from practical experience that probably over the last 25 years the percentage of loans made for the consolidation of debts has remained very, very static.

COMMISSIONER LEMAN: But suppose that in times of high activity your industry -- and I will exaggerate this to make the point -- managed to get all the used cars on the road, all of them, would that not have some effect on the total expenditure? You have to make them keep going on the road afterwards.

DR. EATON: Undoubtedly if they cleaned off all the second-hand lots there would be an upsurge in the purchase of new cars along with it.

COMMISSIONER LEMAN: Now, Dr. Eaton, you make another point, you argue from the nature of the loan your industry makes, and then you shift your ground and talk about another factor, and that is the fact that they are not outfits that accept deposits?

DR. EATON: Yes.

COMMISSIONER LEMAN: Or finance primarily

with very short-term paper, and you have explained to us a little earlier that you start on the short-term and gradually try to convert your debt with long-term funds. Could we interpret this argument of yours to the effect that the fact that certain industries do accept deposits from the public would be a criterion for the monetary authorities in deciding to control or not control?

DR. EATON: I don't think I am equipped to answer that question, sir. No, I don't think that is the implication; I think you are perhaps getting into the field here of the distinction between a bank and a near bank, maybe not, but I wouldn't attempt to make any distinction there and I think I am confining my remarks to our own industry and I don't think I would venture an opinion in this field. That is the fact that a company accepts deposits, whether that is grounds for, in effect, believing that controls shouldn't be extended over these companies. I would rather not answer that question.

COMMISSIONER LEMAN: You don't like people to reverse an argument on you?

DR. EATON: That is right.

COMMISSIONER LEMAN: Then, to go on from there. In paragraph 29 you seem to make another argument, you seem to imply that the general action of monetary policies in the control of money supply and the general cost of credit wouldn't tend to influence the level of operations of the consumer

loan industry.

DR. EATON: I think that is true because of the different nature of the companies.

COMMISSIONER LEMAN: Well now, isn't it generally true that what has caused people interested in the effectiveness of monetary policy to go in for more selective types of control or to extend the types of control, or the tools with which monetary policy can operate, is the fact that there are large sectors in the policy that can by-pass the expected effects of the general broad action.

DR. EATON: I expect it is, although my position here in this memo is that to be as effective as they need to be they don't have to extend down into direct controls. I think that is essentially my position here.

I can openly state that I don't think that tight money policy will affect, ~~really~~, very much the total volume, particularly of the companies that have access to funds from their parent companies.

It has been pointed out I think in the other memo that the tight money policy hits very unevenly and that it would in certain directions cramp the style of certain members of the association, but having pointed out that 65 per cent of the business is done by, say, two companies, I am saying that generally looked at as a total, I don't think monetary policy would have much effect other than by increased cost and some change in the

quality of credit risk that they will take, but generally as things are usually expanding in our industry in good times, I don't think you can make any assumption that there would be a decrease or very much slowing down; it would be a loss of profits, probably, less profit, but after having said that -- that is, that I don't think monetary policy would be very effective to our industry -- I finish up by saying I don't think it should be anyway, and that is where I started in.

COMMISSIONER LEMAN: Well then, I would like to ask you a question that stems from this reasoning which you have made, and that is wouldn't you worry that because monetary policy does have uneven effects on various people, that by restricting to the commercial banks its entire operation, letting it flow through only the commercial banks, that this leads to putting the burden on them in certain conditions of resorting to a rationing, and that type of thing, and sometimes rationing against people who are in competition with the banks and where there is an overlapping?

DR. EATON: Well, I think my view is this; you can say that with this tightening up on the commercial banks it still leaves others free.

Now, again I come back, I think, to the proportions and as to how important that volume of what you might say commercial lending is outside the banking system. My own view, without knowing too much about it, is that I don't think it is very important.

I don't think it is sufficiently important for the chartered banks to have to lie awake nights worrying about it.

COMMISSIONER LEMAN: Would you want the government or the monetary authorities to decide how much of the restriction should be extended to your industry, or would you like the bankers to decide that?

DR. EATON: Well, I think it is not entirely inevitable, but it is pretty much a conclusion that you have to come to that the banks themselves can, or have it in their power to, decide who to lend to and who not to lend to; who to tighten up on and who not to tighten up on. I think a person can assume that they will go right across the board and make a reasonable distribution of the tightening up.

Your question was as to whether I would sooner have them do that rather than the government? So far as direct controls are concerned, I would not want anybody to do it. I think that the present method with the central bank watching the position of the chartered banks is a good system of control and is sufficient, and I would not extend it down to direct controls which I think you get into once you depart from those who are in the clearing system and who are directly in the banking system. It would be bad to go beyond that because direct controls -- I think I will answer your question by saying that I would let the banks go ahead in deciding who and who not to cut down on, and let the rest alone.

COMMISSIONER LEMAN: So that I understand your thinking, when you say the present system or the past system of administering monetary policy is enough,

when you say the tools are sufficient, should I interpret that to mean that you think that it is effective; that it works for the purposes you think it is designed to work for?

DR. EATON: Yes, I do.

COMMISSIONER LEMAN: Many people think that monetary policy has been mostly a failure. Many people think that, you know.

DR. EATON: Well, depending on what they are supposed to do -- I would not say they have been a failure in controlling, or in attempting to control in so far as they are able, price levels in this country. I do not think the question has arisen. I think much misunderstanding has arisen because of the fact that the banks have been expected to stop things which have had nothing to do with the supply of credit. If you call that a disappointment in monetary policy, then I think it is a mistaken disappointment. I think they have been blamed for many things they should not have been blamed for.

During the Korean crisis you could not expect the banks to stop the 15 per cent price increase that took place at that time. That was caused by the sort of panic buying that cannot be stopped by ordinary means.

I am not too sure of what caused the price rise in 1956, but I do not think they were responsible one way or another. I do not think there would have been inflation in any case. I think we would have had a stable price level regardless of what the banking

policy had been in other years. They cannot start things up when they want to. We have seen that. They are quite inadequate to push or start things in the business world when the climate is not right.

COMMISSIONER GIBSON: You seem to be arguing that monetary policy is not very effective. Indeed, you make reference to the possible need for a wages policy.

DR. EATON: Yes, I think the price level factor that has been worrying people so much recently and in the past decade is not a thing that can be taken care of by monetary policy at all.

COMMISSIONER GIBSON: Do you think that monetary policy can be helpful or unhelpful in a certain environment, or do you just rule it out?

DR. EATON: I do not think it can be very helpful in certain cases. You can tighten down so much that you will put people out of employment. Perhaps that will tend against rising and immoderate wages, but it is not a very effective way of doing it.

COMMISSIONER GIBSON: I cannot quite follow whether you are saying it is not much use -- which, of course, would make the job of this Commission much easier -- or whether you are saying that in some circumstances it has an important part to play.

DR. EATON: I go back again to 1956. I do not profess to know whether in that year monetary policy was terrifically important in attempting to stop a price level increase which was appearing on the

surface. I do not know, and I do not profess to know, but I think what I am saying is that supplying ordinary business demands -- that is a very vague phrase -- has not had much to do generally with price levels in Canada in the last decade.

COMMISSIONER GIBSON: It is when those demands suddenly increase and you get a rapid upward movement, and similarly when you get a downward movement, that there is reason to think about changing monetary policy?

DR. EATON: I do not think they can slow things up much on the down grade, but I think this so-called inflationary trend comes about at about the time industry generally is operating with unfilled orders -- when business is that good and that tight. I do not know too much about it, but I have seen a lot of cases and I have asked people: "When do you increase prices? Do you increase prices because you think the market can stand a little bit more?" And they have answered: "For God's sake, no, of course we don't". They just love to keep prices down. The reason these companies will increase prices is because their costs have gone up and they want to maintain a margin between their production costs and the selling price. In such a case I do not see a general upward movement in price until things have got so very tight, and there are unfilled orders. I do not find it surprising to find a fellow saying: "I can't make a delivery at this price, but I can at this higher price." I think that is what starts the upward trend.

COMMISSIONER GIBSON: And in that situation monetary policy has a part to play?

DR. EATON: Yes, some.

COMMISSIONER GIBSON: But what about in advance of that time?

DR. EATON: Well, if you can guess ahead of time, then you are good.

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COMMISSIONER MACKINTOSH: I can see your pattern, Dr. Eaton, but I think you should add one thing to it, namely, that when the volume of business is going up and businessmen find their costs are going up, they add to their prices to accommodate it. They have been so busy selling goods that they have not had time to look at their costs, and there comes a time when they really set to and start to pare those costs, and unless there is some check you will have this cost inflation which is not by any means self-generating; it is just that the costs have not been any great trouble, and businessmen, year in and year out, do not give the same attention to costs as they do give to them when they reach a period when by rising competition or other factors they discover they cannot raise their prices again,and they really have to get down to the problem and shake the organization up in order to get the costs down and into business again.

DR. EATON: But I think I would add to that that when they come to that period, and are successful in getting the costs down, and they have a safe, or what they regard as an appropriate, margin for profit, they will then bring the prices down, and they are very often very anxious to do that in a strongly competitive situation. That can happen also.

COMMISSIONER MACKINTOSH: You assume strong competition.

DR. EATON: Yes, I do.

COMMISSIONER LEMAN: I am just wondering how far you would extend the reasoning that I find in your paragraphs 10 and 11, Dr. Eaton. In the two or three previous paragraphs you explain clearly that your clients' industry is not a charitable organization; that it responds to ordinary economic factors of supply and demand; that it is a perfectly normal type of business activity. And then you say:

> "Surely consumers rather than their government are the best judges of the extent to which they want to borrow at a price to finance present consumption ..."

and so forth. To what extent are the consumers the best judges of the influence of all their activities. Would you even say that if at times individuals want to raise prices and want to get into a boom there is no reason for trying to stop them?

DR. EATON: No, I do not think so. No, I am not denying, in a sense, the need for controls, or the usefulness of controls, but I think I can confine my assertions to this field, that when a man wants to borrow money and repay it later I think he is pretty well equipped -- or most people are -- to decide that for himself ; if he is not then that is too bad. There are a few people who do not do that properly, but I think the basic assumption is pretty good. I do not say you should let them follow their own inclinations if they want to go out

and kill somebody, but such things as borrowing money and repaying later involve pretty ordinary uncomplicated decisions that the ordinary members of the public are quite adequate to make without having to have somebody in the government to tell them what they should or should not do.

COMMISSIONER MACKINTOSH: You are not thinking here really of cyclical movements?

DR. EATON: No.

COMMISSIONER MACKINTOSH: It is just an attempt to impose old-fashioned conventions?

DR. EATON: Yes, that is right.

COMMISSIONER LEMAN: Could we get back for a moment to your reference in paragraph 37 to the cost-push type of inflation, and you hint that perhaps a wages policy is what is needed. Can you visualize a true government wages policy in our type of economy?

DR. EATON: Oh, I do not know the answer to all these things. Good heavens, I have just stated in a negative way what I think the answer is not. Do not ask me to prescribe a wages policy and say whether it is good or not good. I think there is an unanswered question there, and somebody had better find out the answer, full stop.

COMMISSIONER LEMAN: In paragraph 40 you hint at the fact that the government has also one other instrument of control over the total level of economic activity through the field of housing. Do you applaud this? Do you clap your hands at this,

or ---

DR. EATON: No, not really. The awkward thing about this kind of what you might call fiscal policy is that it usually works in only one way, particularly in this period when we have had such a large volume or an unusual volume of unemployment. Perhaps you can blame the government for pushing more in the housing field, but I cannot see this government in these days cutting down on the volume of housing when there is a tight money policy. They might do that, but I do not think they would. It is a one-way thing. It is a stimulant . I do not applaud it very much, but I am in accord with the fact that it is fairly important as an instrument, although I think it has been mainly used on one side only, and perhaps it has been used unwisely in extent at times.

COMMISSIONER LEMAN: It has been used as a powerful instrument for inducing more expenditure, but never for controlling it?

DR. EATON: Yes, I think that is correct.

COMMISSIONER LEMAN: But that has worked mostly through a system of making credit more available in that field, has it not?

DR. EATON: Yes, I think that is correct, and in the mortgage field that immediately causes an increased demand for furnishings.

All through industry it can be a pretty powerful and far-reaching instrument. Credit extended through mortgages in effect, stimulates quite a large volume of our business.

COMMISSIONER LEMAN: Would you say this is a highly inflationary or deflationary sector in which credit can operate?

DR. EATON: Yes, I think it has been used mainly on the inflationary side, although I do not think it is really inflationary -- it is expansionary rather than inflationary.

COMMISSIONER LEMAN: Dr. Eaton, I think we can get a little mixed up in our discussion sometimes if we do not accept some premises just for the sake of argument as we go along. If you always come back to the fact that the kind of loans consumer loan companies make are not inflationary and should not be controlled, then that settles the argument right there. But, suppose somebody does not agree with you on that? Do you not agree with the general proposition that if authorities find that monetary action is not effective enough because certain industries can get around the very broad and general weapon that is used, then they must ask themselves what more they can do to make that action have a more direct effect? Would that be logical?

DR. EATON: I suppose it would be logical, yes, sir.

COMMISSIONER LEMAN: This is the whole question of near banks, is it not?

DR. EATON: Well, yes, on your assumption that monetary policy as we have known it -- that the sphere of control has proven inadequate. If you have thought it has been inadequate and that there is a need for more control then I suppose logically there must be more direct controls extending beyond it, but I do not agree with the assumption on which that is based. Even if it were logical I think what I am saying is that the situation would have to be terrible before you would be justified in going into direct controls. I am against direct controls very much, as you will have gathered.

COMMISSIONER LEMAN: I think everyone will agree with that, Dr. Eaton, but I think you did say, however, that there is no place for control of this industry in any circumstances. I believe you did use the words "in any circumstances".

DR. EATON: Meaning our industry here?

COMMISSIONER LEMAN: Yes.

DR. EATON: Yes, I think so. If I depart from that it would be in such small pieces that it would be immaterial.

COMMISSIONER GIBSON: Yesterday, as you know, we heard from the sales finance companies. They said that in circumstances where there is a real need there should be some control, and that they would support such measures providing they thought the purposes were sensible and provided also that all the other dispensers of consumer credit were subject to the same

kind of control. I know that these are pretty big provisos. You do not think that there would be any circumstances in which some special measures might be necessary? I recall to you that there have been a couple of times during the post-war period when special things have been done in what would appear to be very difficult situations that came up quickly.

DR. EATON: Well, perhaps you are suggesting that if it is done for one it should be done to all.

COMMISSIONER GIBSON: I am not suggesting that. I am just telling you what somebody else told us, which is dependent, in part, on your attitude.

DR. EATON: Well, I would not agree that it should be done to us because it should be done to them. I think that about sums it up.

COMMISSIONER GIBSON: Would you agree that there are circumstances in which direct controls might be appropriate -- that is, circumstances short of war?

DR. EATON: That is quite a question.

COMMISSIONER GIBSON: I know it is.

DR. EATON: I have not got that good enough an imagination.

COMMISSIONER GIBSON: In the post-war period we have had certain examples.

DR. EATON: Well, we had the Korean episode. I do not know what you could have done fast enough to stop the price increases at that time. You just do the best you can. I do not know how you stop that sort of thing. I suppose that is a situation which might call for controls, if you can impose them fast

enough. I would think that in such a situation controls would be justified, but you could not impose price controls fast enough to stop things happening at that time. It was not credit expansion that was responsible for it. You ask if there is a situation in which such controls would be justified. Well, I suppose there could be, but I am still not too sure how you would go about dealing with the problem and licking it.

THE CHAIRMAN: Gentlemen, that concludes the discussion. We are very much obliged to you for the submissions and the very interesting briefs that have been presented. I am sure they will all be very helpful to us.

MR. OAKES: On behalf of the Canadian Consumer Loan Association may I thank you, sir, and the members of the Commission, for the privilege of appearing and placing our views before you.

THE CHAIRMAN: We shall adjourn now until Thursday, September 27, at 9.15 A.M. when we shall hear a submission from Mr. Sproul, a former president of the Federal Reserve Bank of New York.

--- Adjournment.

Royal Commission on Banking and Finance

CANADIAN CONSUMER LOAN ASSOCIATION

Hearings held at

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CANADIAN CONSUMER LOAN ASSOCIATION

to the

ROYAL COMMISSION

on

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1962

CANADIAN CONSUMER LOAN ASSOCIATION

INTRODUCTION

1. The Canadian Consumer Loan Association is composed of small loans companies and money lenders licensed to make loans to Canadian consumers under the Small Loans Act. Subject to the approval of its Board of Directors as to an applicant's qualifications, all corporations, partnerships and individuals licensed under this Act are eligible for membership. The total outstandings under the Small Loans Act on December 31, 1961, amounted to 992,193 loans for $426,157,346* of which 97% was on the books of members of this Association.

2. The objectives of the Association which was formed in 1944 are as follows:

(a) To improve the operating standards of its members.

(b) To promote, encourage and maintain policies calculated to cultivate public confidence in the Small Loans business.

(c) To compile, make available and disseminate information relating to the said business for use of its members and the general public.

(d) To encourage its members to co-operate with Better Business Bureaux, Chambers of Commerce,

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* Interim Report of the Department of Insurance, Small Loans Companies and Licensed Money Lenders for the year ended December 31, 1961.

Boards of Trade, Welfare Societies and other agencies for the purpose of improving economic and social conditions.

(e) To do all such other things as are incidental or conducive to the attainment of the above objects.

The Code of Ethics of the Association appears as Appendix A of this brief and the list of members appears as Appendix B.

DEVELOPMENT OF A NEED FOR THE CONSUMER LOAN INDUSTRY

3. The regulated consumer loan business developed in response to an urgent social and economic need for a cash loan service to small borrowers and families. This need for satisfactory sources of small loans to consumers has only developed in Canada during comparatively recent years with the change from an agrarian to an industrial economy and the consequent shift of population from rural to urban areas. The result has been the dependence of a growing number of people on cash income rather than on the physical products of their own hands. Early laws did not protect borrowers and many people needing small loans were victimized by unscrupulous lenders charging exorbitant rates.

4. This condition did not develop as early in Canada as in the United States where intensive studies of the problem commenced in 1908. Most active in this field was the Russell Sage Foundation, a philanthropic body dedicated to the improvement of social and living conditions. Studies by the Foundation showed

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laws limiting interest on all loans, regardless of size, were inadequate as far as small loans were concerned since they only prevented small loans being made legally and drove people into the hands of the loan sharks. It was also apparent from experiments with the operation of philanthropic lending agencies that the need for small loans could not be met in this manner. The Foundation concluded that the only answer was to enact laws which would provide small loan rates low enough to protect borrowers but high enough to attract the commercial capital necessary to meet the public need.

5. The Foundation received the support of ethical lenders, welfare organizations and far-sighted business leaders. By 1917, the first laws containing the provisions now known as the Uniform Small Loan Law had been passed in the majority of States.

6. In Canada it was apparent by 1936 that a small loan law was necessary for here, as had happened in the United States, the loan sharks were creating serious social problems.

LEGISLATIVE BACKGROUND IN CANADA

7. Prior to 1940 when the Small Loans Act became operative, there was no effective legislation to protect small sum borrowers. The Money-Lenders Act of 1906 limited to 12% per annum interest on all loans of $500 or less but did not prevent the making of additional charges. The situation which existed

is described very clearly in the preamble to the Small Loans Act:-

> "Whereas it has become the common practice for money-lenders to make charges against borrowers claimed as discount, deduction from an advance, commission, brokerage, chattel mortgage and recording fees, fines and penalties, or for inquiries, defaults or renewals, which, in truth and substance are in whole or in part, compensation for the use of money loaned or for the acceptance of the risk of loss or are so mixed with such compensation as to be indistinguishable therefrom and are, in some cases, charges primarily payable by the lender but required by the lender to be paid by the borrowers; and whereas the result of these practices is to add to the cost of the loan without increasing the nominal rate of interest charged so that the provisions of the law relating to interest and usury have been rendered ineffective;"

Thus there were no legal means of preventing lenders from making extra charges of various kinds with the result that borrowers, lacking the bargaining power usually present in commercial transactions, often found themselves saddled with burdens of debt from which there was no apparent escape. At the same time, they were subjected to the harsh collection

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methods common among lenders of that era.

8. A small group of ethical lenders who were operating under special private acts, did not condone such practices and made every effort to bring these conditions to the attention of responsible people to the end that overall effective legislative action might be taken. These efforts led eventually to a complete examination of the subject by successive parliamentary committees between 1936 and 1939. During these hearings witnesses appeared representing social agencies in Canada and the United States, banks, credit unions and the responsible lenders. The best qualified technical witness was Mr. Leon Henderson, a consulting economist who, from 1925 to 1933, was Director of the Remedial Loans Division of the Russell Sage Foundation. A copy of Mr. Henderson's testimony, taken before the Banking and Commerce Committee of the House of Commons in 1938 appears as Appendix C.

9. The final report resulting from these various parliamentary studies was issued June 1, 1938, by the House of Commons Banking and Commerce Committee and appears as Appendix D. The emphasis this Committee placed on the importance of setting as low a rate as possible as indicated in the statement appearing in the fourth paragraph on page 424 of the Committee's report as follows:

> "Throughout its enquiry your Committee's objective has been to secure the best procurable rate for the borrower."

The Committee makes further reference to rate in the next

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> "Obviously the State can intervene advantageously over rates only within a limited field; for naturally a legislative rate at which money is not obtainable is of doubtful benefit to necessitous people. In the debates over the subject it would almost seem to have been at times forgotten that to legislate a maximum rate is an injunction that, if people cannot borrow at the prescribed rate, they cannot borrow at all."

10. The principal conclusions of the Committee were:

(1) Our economy creates the need for instalment loans to wage-earners and salaried people.

(2) The cost-ratio of small loans is considerably higher per dollar loaned than in the case of larger loans and therefore a higher rate is necessary.

(3) Existing legislation does not provide the protection that borrowers should have against excessively high rates.

11. The Small Loans Act as passed in 1939 set the "cost of loan" at a maximum of 2% per month on reducing balances. Such cost included all charges for any loan of $500 or less. The Act fulfilled its purpose and licensed, supervised consumer loan service became available across Canada and resulted in the virtual

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elimination of loan sharks.

12. The Act also provides for licensing, inspection of lenders' books and records, and annual returns by lenders to the Superintendent of Insurance for Canada. This is a most comprehensive return which fully discloses all details of the operation as will be seen by the copy of the Superintendent's Annual Report which appears as Appendix E. In connection with licensing, Section 5(2) of the Act states:

> "The Minister may issue a license to any person upon being satisfied that the experience, character and general fitness of such person, or if such a person is a corporation, of the officers and directors of the corporation, are such as to warrant the belief that the applicant will, if granted a license, carry on with efficiency, honesty and fairness to borrowers the business of money lending pursuant to this Act."

13. By 1956 when the Act had been in force for sixteen years without revision, it became apparent that with the post-war growth of the economy there had been a tremendous increase in the demand by consumers for loans over $500. This is evidenced by the fact that at the end of 1956 out of a total of $343 million in loans outstanding on the books of licensed consumer loan companies and their affiliates, only $88 million, or 26% represented loans up to $500 and therefore under regulation. After extensive study by the House of Commons Banking and Commerce Committee, the Act was amended to extend the area

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of regulation to cover all loans up to $1,500 under the following conditions:

(1) Maximum rates:

2% per month on any part of the unpaid principal balance not exceeding $300,

1% per month on any part of the unpaid principal balance exceeding $300 but not exceeding $1,000,

½% per month on any remainder of the unpaid principal balance exceeding $1,000 but not exceeding $1,500.

No refinance charges or any other charges whatsoever may be made under the terms of the loan contracts.

(2) The cost of any loan or any part of it cannot be compounded or deducted in advance.

(3) In the case of loans for $500 or less made for more than 20 months, and loans between $500 and $1,500 made for more than 30 months, the rate must not exceed 1% per month on unpaid principal balances. Similarly, if part of any loan remains unpaid after the due date of the final instalment shown in the contract, the rate shall not exceed 1% per month on the unpaid balance.

(4) If more than one loan is made to one person or to a husband and wife, the same rates apply as though one loan for the same total amount was made.

(5) Loans shall be repayable in approximately equal monthly instalments.

(6) The borrower may repay the loan or any part of it on any instalment date, without notice, bonus or penalty.

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14. It is interesting to compare rates in the Canadian Small Loans Act with legal rates in other countries. The schedule appearing as Appendix F sets out the maximum legal rates under the various acts of the state legislatures in the United States and it can be seen from this the Canadian rates are lower in every instance.

15. Perhaps the most important effect of the 1956 amendments to the Act was the widening of its scope to encompass all loans up to $1,500 with the inevitable increase in the proportion of consumer loans coming under the regulation of the Act. By the end of 1961, of the $548 million reported by the Bank of Canada as outstanding on the books of licensed consumer loan companies and their affiliates, $426 million, or 77%, represented loans of up to $1,500 and therefore under regulation. A copy of the Act and an explanatory digest of it appear as Appendices G and H.

OPERATION OF THE ACT

16. Complaints to the Department of Insurance about loans made under the Act by licensed lenders have been rare. This is noteworthy in the light of the more than one million loans made annually. Members of the Canadian Consumer Loan Association are continually alert to the possibility of illegal lending activity which occasionally comes to light in connection with unlicensed lenders. In these cases the information is cleared through the Association Headquarters and passed on to the Department of Insurance for investigation and

such other action as the Superintendent may direct. This manifest desire on the part of members of the Association to see the Act achieve its purpose has undoubtedly had much to do with the successful operation of the Act.

17. In Great Britain the law is not as positive as in Canada and the United States. The law there sets no direct limit on the rate of interest a money lender may charge. It does specify, however, that if the rate is greater than 48% per annum, the money-lender must show, in any proceeding in respect of money lent, why the Court should not consider the rate excessive. Conversely, where the rate is less than 48%, the borrower must show the Court why it should consider the rate excessive.

18. The following table shows the effective rates resulting from the rates set out in the Small Loans Act:

TABLE 1

Amt. of Loan	Rates (Small Loans Act)	Rate per month	Rate per Annum	Lenders' Gros Revenue per $ Loaned per Ye
$ 300	2%	2.00%	24.00%	$13.48
$ 500	2% - $300 1% - $301-$500	* 1.81%	21.72%	$12.15
$1,000	2% - $300 1% - $301-$1,000	* 1.48%	17.76%	$ 9.87
$1,500	2% - $300 1% - $301-$1,000 ½% - $1,000-$1,500	*1.27%	15.24%	$ 8.44

* Average rate when loan is paid according to contract.

THE COMPONENTS OF CONSUMER CREDIT

19. Consumer credit falls readily into two main divisions which are quite distinct but are often confused by many who discuss them. These two divisions are:

(1) Instalment sale credit.

(2) Instalment cash loans.

The one common denominator between instalment sale credit and instalment cash loans is the requirement of regular payments through which the debt is repaid. There, however, the similarity ends.

20. Instalment sale credit supplies the funds for purchases which people do not wish to or are unable to make out of savings and is advanced directly by retailers or through sales finance companies. The credit is secured by a lien on the merchandise. Title and ownership do not pass to the purchaser until the final instalment is paid. Sales finance companies which specialize in this service to dealers rarely deal directly with the purchaser in assessing his credit-worthiness.

21. The chief function of cash personal loans is to enable families to re-organize their financial affairs and help them to recover from emergencies created by unexpected demands or interruption of income. This permits families to work their way out of debt at a pace suited to their earnings.

22. Consumer loan companies in extending cash credit deal directly with the borrowers and are fully responsible for investigation of their credit standing as well as for the administration and collection of the loans. Since the majority of loans are made without

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liquid or readily saleable security, lenders must regard character and paying ability as of prime importance and therefore must ensure these factors are accurately assessed.

23. In addition to consumer loan companies, banks and credit unions serve the consumer loan field. As consumer credit has attained a more widespread acceptance and the philosophy of saving for goods and services while enjoying their use has become more generally accepted, the banks have increased their service in this field. While all of the banks' business in this area is shown as "loans", it can be assumed that a large percentage of their "loans" are for the purpose of financing sales of motor cars, household appliances and other durable goods. The Bank of Canada Statistical Summary for February, 1962, reports that at December 31, 1961, the chartered banks had $1,030 million outstanding in consumer loans.

24. The banks are interested in serving the consumer loan field. They have a ready source of low cost funds available and this additional service they now provide fits in well with the variety of services they have always offered. On the other hand, their lower rates of charge impose a limit upon the costs which a bank can incur in investigating credit-worthiness of applicants and in servicing and collecting loans. Bank management, aware of the cost limitations and of its responsibilities to depositors, usually sets materially higher credit standards in selecting risks than do other types of consumer credit

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institutions.

25. Credit unions in recent years have experienced much the same growth rate as banks and consumer loan companies and now have a considerable share in the consumer loan total. By the end of 1960, there were over 4,600 credit unions in Canada with 2½ million members and assets totalling more than 1¼ billion dollars.

26. Credit unions have definite limitations in that their services are available only to their membership which is usually restricted to a more or less homogeneous group of people with some common bond of interest. They generally stress low rates of charge compared with other types of institutions and they also stress idealistic or moralistic motives of helpfulness to fellow members. However, an individual who has access to credit union services can, and frequently does, use the services of a bank, a consumer loan company or other lending institution, depending on his ability to meet their credit standards or on the degree to which his particular needs can be served by them.

27. There are several reasons for credit unions' ability to make loans at lower rates than consumer loan companies not the least of which is their complete exemption from income tax. In addition, they are able to effect substantial operating economies through voluntary unpaid workers -- rent-free space (especially in the case of industrial credit unions) - less extensive credit checking of loan applicants - lower collection and payment processing expense (particularly where payroll deductions are in force).

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28. Experience indicates the range in the field of consumer loans is so wide as to borrowers' character, capacity, stability and other factors which constitute his credit stature, that it is unlikely ever to be adequately or completely served by one type of institution whether it be banks, credit unions or consumer loan companies. While the banks have a larger share than either credit unions or consumer loan companies, these two, between them, comprise half the consumer loan segment of the consumer credit field.

29. The consumer loan companies are unique in that they are the only source of consumer loans which is available to many thousands of families who cannot or do not wish to be members of credit unions or meet bank requirements. A further difference is the fact that they do not accept deposits but are dependent on commercial capital to satisfy their borrowers' requirements. They are also highly specialized in that they concentrate on consumer loans.

30. Consumer credit is generally regarded as consisting of contractual obligations entered into by consumers but not as house buyers for personal rather than business reasons. As such, it includes indebtedness incurred in the form of charge accounts, commitments to pay for goods and services in instalments and personal borrowing without attendant collateral in the form of stocks and bonds.

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and the figures composing it are taken from Bank of Canada publications as indicated.

TABLE 2

CREDIT EXTENDED TO CONSUMERS BY RETAIL DEALERS AND CERTAIN FINANCIAL INSTITUTIONS

December 31

	(Millions of Dollars) 1949	1957	1961	(% of Total Consumer Credit) 1949	1957	1961
CASH LOANS						
Banks (1)	173	421	1,030	21.1	15.9	27.1
Consumer Loan Companies (2)	77	347	548	9.4	13.1	14.4
Credit Unions (3)	63	258	425 (5)	7.7	9.7	11.2
Total	313	1,026	2,003	38.2	38.7	52.7
SALE CREDIT						
Retail Dealers (4)	389	826	1,006	47.6	31.2	26.4
Instalment Sales Finance Cos.	116	780	760	14.2	29.5	20.0
Consumer Loan Companies	-	15	35	-	.6	.9
Total	505	1,621	1,801	61.8	61.3	47.3
TOTAL CONSUMER CREDIT	818	2,647	3,804	100.	100.	100.

Sources: Bank of Canada Statistical Summary Financial Supplement, 1957 (1949 figures).
Bank of Canada Statistical Summary, February, 1962 (1957 & 1961 figures).

NOTES: (1) Loans to individuals other than for business purposes or home improvements and not fully secured by marketable stocks and bonds.

(2) Loans made by companies licensed under the Small Loans Act and affiliated companies usually repaid in instalments.

(3) Not secured by mortgages.

(4) Charge account credit and instalment sale credit combined.

(5) Latest available - December 31, 1960.

The year 1949 was selected because it is the year chosen by the Dominion Bureau of Statistics as its base year. The year 1957 was chosen because it was in 1958 the banks commenced a much more concerted effort to develop business in the sales finance and consumer loan fields by setting up special departments for this purpose.

32. It can be seen from this table that with only 14.4% of the total, consumer loan companies do not comprise one of the major segments of consumer credit. Banks with 27% of the total and retail dealers and instalment sales finance companies with 26% and 20% respectively are the major participants. Nevertheless, with 992,000 loans of $1,500 or less accounting for $426,000,000, it can readily be understood that the role of the consumer loan companies is of real importance to those families which use their service in amounts averaging about $425 each.

33. In examining further the percentage section of the table, several points stand out. The banks' share of the total, which declined over 5% in the eight years from 1949 to 1957, rose sharply by over 11% in the four years ending December 31, 1961. Significantly, the sales finance companies and retail dealers decreased 9.5% and 4.8% respectively and at the same time the relative growth of consumer loan companies and credit unions slowed down.

LENDING OPERATIONS

34. The offices of modern consumer lenders are set up to provide efficient service to customers in locations which are readily accessible. Since privacy

is important to consumer borrowers, lenders provide interviewing rooms for loan discussions in addition to general office area.

35. Although some loans are made to enable the borrower to take advantage of a business opportunity or to make an advantageous purchase, the majority of prospective consumer loan customers come to the lender because of some family financial difficulty. In these circumstances, it is important that the lender consider the applicant's problem in detail and assist in every way possible to find a solution. Thus the preliminary interview in the lender's office usually encompasses much more than simply filling in an application form. In many cases intervention between the applicant and his existing creditors and general financial counselling occupy a considerable amount of the interviewer's time.

36. After careful investigation most lenders find only about 50% of applications actually result in loans being made. It is not in the best interests of the lender or the applicant to make a loan when it appears that he is over-reaching his credit and may have difficulty making repayment.

The main considerations in judging an applicant's eligibility to borrow are:

(a) Character - This includes evidence of family accord as well as the applicant's attitude toward his problem. To obtain this knowledge sometimes requires confidential checking with various sources.

(b) Earning Ability - This is determined by seeing paycheque stubs or envelopes, T4 slips and commission

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The main considerations in judging an applicant's eligibility to borrow are:

(a) Character - This includes evidence of family accord as well as the applicant's attitude toward his problem. To obtain this knowledge sometimes re- [illegible]

(b) [illegible] - This is determined by seeing pay-cheque stubs or envelopes, T4 slips and commission

statements. The interviewer must be familiar with going rates for various trade classifications in the area and general employment conditions in the local industries.

(c) Stability of Employment - It is desirable that the applicant has a good work record and indication of job stability. Badge numbers and other evidence of employee seniority may be seen.

(d) Other Sources of Income - This is checked by seeing pension papers, direct checks with part-time or after-hours employers, knowledge of going rates for rentals of rooms, flats, etc.

(e) Existing Debt Commitments - These are mainly ascertained in the office interview. Other sources include credit bureaux, registry offices and lenders' exchanges. Under the sponsorship of the Canadian Consumer Loan Association, offices for the reporting and clearing of loan information have been established in several major areas and others are in process of formation. The establishment of these exchanges demonstrates the desire of lenders to exercise sound credit control.

(f) Paying Record - Interviewers ask to see payment booklets on current instalment accounts, credit cards and, sometimes, receipts for rent or mortgage payments. These may also be checked through credit bureaux or by direct contact with creditors.

(g) Essential Living Costs - These are determined through consideration of such matters as number in the family,

location and type of housing, fuel expense, insurance, operation of automobile and other fixed family expenses.

(h) Evidence of Family Co-operation - This is usually determined by extent of mutual interest of husband and wife in the purpose of the loan, contributions of employed children to family income, etc. It is sometimes necessary to visit the applicant's home to view the home surroundings at first hand to establish evidence of family co-operation and character.

(i) Ownership of Security - This is established by checking for instalment payment accounts, search of registry office, direct contact with dealers and direct questioning during the interview.

37. The transaction of a loan begins when a complete stranger enters the office and requests a loan. He is assigned to a private interview room where, with the assistance of an interviewer, he completes an application form on which he gives all the necessary information. By analyzing this information in conjunction with the purpose for which the money is to be used, the interviewer and the applicant are able to tentatively arrive at the size of loan and monthly payment program which will best accomplish the purpose and fit into the applicant's ability to repay. The next step is to check and verify the applicant's circumstances, paying habits, indebtedness and income. When the investigation is completed, lender and borrower finally determine the

amount of the loan and agree on the monthly payment plan and the necessary documents are prepared. In most cases lenders arrange for both husband and wife to be present to receive the explanation of the loan and sign the documents so that family co-operation is ensured.

38. The need for detailed and careful supervision of a large number of payments is an inevitable result of making many small-sum instalment loans. Reminder notices, telephone calls, letters and, in some cases, visits to the home are used to control delinquency. Borrowers often encounter new emergencies which require consultation with the lender and a complete review of their circumstances. Sickness, accidents, temporary lay-offs and strikes interrupt the normal receipt of borrowers' incomes with the resulting need of arranging new contract terms or re-arranging existing payment plans. The relatively good write-off record in the consumer loan business is achieved by close attention to each individual account.

39. Because the total number of borrowers on the books of consumer loan companies has shown an increase for several years (see Table 3) some critics have suggested that consumer borrowers remain almost perpetually in debt to loan companies. While it is often necessary for borrowers to obtain additional money before the original loan is repaid, Table 4 shows that the criticism referred to has been exaggerated.

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TABLE 3

SMALL LOAN BALANCES OUTSTANDING - SMALL LOAN COMPANIES & LICENSED MONEY LENDERS

December 31

Year	Number of Accounts	Total Loan Balances	Average Loan Balance
1951	442,959	$ 60,259,902	$136
1952	467,594	76,990,337	164
1953	482,976	81,840,415	169
1954	523,628	88,822,891	170
1955	529,704	88,844,506	168
1956	543,394	88,428,203	163
* 1957	812,135	229,199,629	282
1958	892,111	315,827,669	354
1959	920,747	360,019,949	391
1960	957,965	391,548,554	409
1961	992,193	426,157,346	429

* First year of increase of limit of Small Loans Act from $500 to $1,500.

Note: Data from Superintendent of Insurance Reports.

TABLE 4

Year	No. of Loans Outstanding 1st of Year	No. of Loans Made to New & Former Borrowers	Total Borrowers Dealt With	No. of Loans Outstanding Year End	No. of Loans Paid Off During Year	Percent Paid Off
* 1957	543,394	505,750	1,049,144	812,135	237,009	23%
1958	812,135	493,848	1,305,983	892,111	413,872	31%
1959	892,111	376,473	1,268,584	920,747	347,837	27%
1960	920,747	369,110	1,289,857	957,965	331,892	25%

* First year of increase of limit of Small Loans Act from $500 to $1,500.

CHARACTERISTICS OF BORROWERS

40. The following tables, numbers 5 to 10, present a general picture of the people that use the services of consumer loan companies:-

TABLE 5

LOANS MADE BY SMALL LOANS COMPANIES AND MONEY LENDERS - 1960

Amount	Number	%	Amount	%
$100 and Less	36,285	3.3	$ 2,613,467	.5
101 to 200	167,619	15.4	25,147,466	4.6
201 to 300	174,979	16.0	43,011,381	7.8
301 to 400	140,974	12.8	48,547,975	8.9
401 to 500	65,318	6.0	28,959,558	5.3
501 to 600	121,371	11.0	64,893,560	11.8
601 to 700	75,708	7.0	48,736,220	8.9
701 to 800	75,795	7.0	56,627,760	10.3
801 to 900	54,829	5.0	46,541,571	8.5
901 to 1,000	165,077	15.0	163,704,318	29.9
1,001 to 1,100	8,829	.8	9,319.941	1.7
1,101 to 1,200	3,206	.3	3,719,125	.7
1,201 to 1,300	2,087	.2	2,628,344	.5
1,301 to 1,400	1,628	.13	2,181,257	.4
1,401 to 1,500	807	.07	1,192,528	.2
	1,094,512	100 %	547,824,471	100 %

41. Because the detailed information appearing in Tables 6 to 10 is not produced by all companies, these tables are based on an analysis of the figures of major consumer loan companies representing 65% of the total business under the Small Loans Act and show distribution of loans by occupation of borrower, purpose of loan, income and age of borrower, as well as the ratio of average loan size to average income.

TABLE 6

DISTRIBUTION OF LOANS BY PRINCIPAL PURPOSE - 1960

Reason for Borrowing	Percent of Total Number of Loans Made
Consolidation of Debts	31.69
Clothing	7.75
Fuel	1.46
Rent	.88
Medical Expenses	6.14
Automobile	11.08
Travel	11.03
Education	.41
Investment	.89
Household Repairs	5.26
Furniture	5.53
Taxes	3.13
Assisting Relatives	4.62
Insurance Premiums	1.76
Moving Expenses	1.20
Mortgage & Interest	.81
Miscellaneous	6.36
Total	100.00

TABLE 7

DISTRIBUTION OF LOANS BY OCCUPATION OF BORROWER - 1960

Occupation	Percent of Total Number of Loans Made
Skilled - Semi-skilled	46.58
Unskilled	16.46
Service Workers	7.57
Sales Persons	3.36
Clerk & Kindred Workers	8.87
School Teachers	.63
Federal, Provincial, County, City	6.60
Managers, Officials, Proprietors	3.62
Professional	2.82
Farmers	1.91
Pensioned & Independent	1.47
Miscellaneous	.11
Total	100.00

TABLE 8

DISTRIBUTION OF LOANS BY BORROWERS' MONTHLY INCOME - 1960

Monthly Income	Percent of Loans made by Borrowers' Monthly Income As Percent of Total Loans		
	By Number		By Amount
$ 0 - $100.00	.36		.14
100.01 - 200.00	7.69		3.75
200.01 - 300.00	26.33		20.45
300.01 - 400.00	33.59	78.74%	35.34
400.01 - 500.00	18.82		22.66
500.01 - 1500.00	13.21		17.66
Total	100.00		100.00

TABLE [illegible]

DISTRIBUTION OF LOANS BY OCCUPATION OF BORROWER [illegible]

Occupation	Percent of Total Number of Loans Made
Skilled - Semi-skilled	46.58
Unskilled	15.46
Service Workers	[illegible]
Sales Persons	3.36
Clerk & Kindred Workers	[illegible]
School Teachers	[illegible]
Federal, Provincial, County, City	[illegible]
[illegible]	3.02
[illegible]	[illegible]
[illegible]	[illegible]
Pensioned & Independent	[illegible]
Miscellaneous	[illegible]
Total	[illegible]

TABLE 8

DISTRIBUTION OF LOANS BY BORROWERS' MONTHLY INCOME - 195[illegible]

Monthly Income	Percent of Loans made by Borrowers' Monthly Income As Percent of Total Loans: By Number	By Amount
$ 0 - $100.00	.36	.14
100.01 - 200.00	7.69	[illegible].75
200.01 - 300.00	[illegible]	[illegible].45
300.01 - 400.00	[illegible]	[illegible].34
400.01 - 500.00	[illegible]	[illegible].56
500.01 - [illegible]	[illegible]	17.55
Total	100.00	[illegible].00

TABLE 9

DISTRIBUTION OF LOANS BY AGE OF BORROWER - 1960

Age of Borrower	Percent of Loans Made by Age as Percent of Total Loans: By Number		Percent of Loans Made by Age as Percent of Total Loans: By Amount
Less than 20	.72		.34
20 - 24	12.15		8.14
25 - 29	16.17		15.03
30 - 34	15.84	71.58%	16.46
35 - 39	14.88		16.30
40 - 44	12.54		14.12
45 - 49	10.54		11.91
50 - 54	7.91		8.61
55 - 59	5.21		5.42
60 - 64	2.68		2.50
65 & Over	1.01		.73
Not reported	.35		.44
Total	100.00		100.00

42. Table 8 shows that nearly 79% of borrowers fall within a monthly income range from $200 to $500, while Table 9 shows that nearly three-quarters fall within the age group from 20 to 44. This is to be expected. The majority of borrowers use the services of consumer loan companies mostly during their early adult years when family responsibilities are heaviest in relation to income.

TABLE 9

DISTRIBUTION OF LOANS BY AGE OF BORROWER - 1959

Percent of Loans Made by Age as Percent of Total Loans

Age of Borrower	By Number		By Amount
Less than 20	.72		.34
20 - 24	12.15		8.14
25 - 29	16.17		15.03
30 - 34	15.84	71.53%	16.46
35 - 39	14.83		16.30
40 - 44	12.54		14.12
45 - 49	10.54		11.91
50 - 54	7.91		8.61
55 - 59	5.21		5.42
60 - 64	2.68		2.59
65 & Over	1.01		.73
Not reported	.35		.44
Total	100.00		100.00

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TABLE 10

RATIO OF AVERAGE SIZE LOAN TO AVERAGE MONTHLY INCOME BY BORROWERS - 1960

Monthly Income	Ratio of Average Size Loan to Average Monthly Income
$ 0 - $100.00	2.44
100.01 - 200.00	1.52
200.01 - 300.00	1.55
300.01 - 400.00	1.57
400.01 - 500.00	1.42
500.01 - 1500.00	1.13
Total	1.44

43. Table 10 shows the close relationship between income and loan size. If the first and last classifications of $100 or less and over $500 are disregarded, it is apparent that there is very little variation in the ratio of loan size to income in the remaining classifications. This tends to substantiate the contention that the majority of borrowers take a sensible approach to the use of credit and weigh their requirements carefully against their repayment capacity. It also points up the care exercised by lenders in assessing the credit worthiness of their customers.

DELINQUENCY

44. The Small Loans Act in Part 1, Section 6 (1), requires "Every loan shall be repayable in approximately equal instalments of principal or of principal and cost

of the loan at intervals of not more than one month each", and goes on to provide procedures in case of default. This requirement imposes on lenders and borrowers the need to agree on a due date for monthly instalments within the limitations of length of contracts which are also regulated by the Act.

45. Monthly due dates thus become the most important check points in regulating the progress of the repayment of consumer loans. They are carefully chosen after discussion between lender and borrower to avoid conflict with other regular monthly obligations and are prominently shown on documents signed by the borrower and on the payment booklet given to the borrower at the time the loan is made. Customer accounts are filed by dates and all lenders employ a system whereby these are examined daily so that overdue accounts may be followed up according to the lender's delinquency control policy.

46. Lenders are well aware that it is in their own interest to pursue a fair and reasonable collection policy designed to maintain a high level of collection efficiency while retaining the good will and co-operation of borrowers.

47. Evidence of collection policies may be seen from Tables 11 and 12 which were compiled from figures taken from the Annual Reports of the Superintendent of Insurance.

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TABLE 11

Year	Number of Loans Made on Chattels	Number of Seizures of Chattels	Number of Seizures per 1000 Loans Made	Number of Branch Offices	Number of Seizures per Branch
1957	713,616	944	1.3	836	1.12
1958	718,343	1,310	1.8	892	1.46
1959	698,565	1,388	1.9	979	1.41
1960	805,270	1,818	2.2	1,074	1.69

TABLE 12

Year	Number of Loans Made	Number of Legal Actions Taken	Number of Legal Actions Per 1000 Loans Made	Number of Branch Offices	Number of Legal Actions Per Branch
1957	1,075,322	1,610	1.4	836	1.92
1958	1,107,500	2,176	1.9	892	2.43
1959	1,097,226	2,270	2.0	979	2.31
1960	1,094,512	2,899	2.6	1,074	2.70

48. While the foregoing tables illustrate that lenders seldom resort to legal actions and seizures to collect their accounts, Table 13 which follows, shows that numbers of consumer loan borrowers do become delinquent in varying degrees during the term of their loan contracts.

TABLE 13

DELINQUENT ACCOUNTS RELATED TO NUMBER OF SMALL LOANS OUTSTANDING

December 31

Year	Under 2 Months Arrears	% of Total Loans O/S	2 to 6 Months Arrears	% of Total Loans O/S	Over 6 Months Arrears	% of Total Loans O/S	Total No. in Arrears	% of Total Loans O/S
1957	128,105	15.7	44,214	5.4	24,556	3.1	196,875	24.2
1958	147,637	16.5	57,790	6.4	29,519	3.3	234,946	26.2
1959	155,006	16.8	65,613	7.1	36,565	3.9	257,184	27.8
1960	171,091	17.8	77,421	8.1	45,221	4.7	293,733	30.6

Note: O/S - Outstanding.

Most delinquency is caused by temporary interruption of borrowers' incomes due to layoffs, strikes, etc., and is included in the totals despite the fact that some arrangement has been reached between lender and borrower to carry the account in arrears. A few cases give evidence of misrepresentation or fraud and these are the ones which require legal process to adjust.

49. Some cases of delinquency are created by serious illness, family break-up or absconding debtors and become write-offs despite the lender's best efforts to prevent this. Some write-offs are voluntarily made by lenders when they become aware of personal misfortunes which would cause undue hardship to borrowers who continued to make payments despite their circumstances. Table 14 records write-offs in the inudstry related to average amounts of loans outstanding for the years since the Small Loans Act was amended to provide for a ceiling of $1,500.

TABLE 14

Year	Written Off Ledger Values	* Average Amount Outstanding	Net % of Write-offs to Outstandings
1957	$1,567,029	$158,813,916	.9
1958	2,400,590	272,513,649	.8
1959	2,789,172	337,923,809	.8
1960	3,482,897	375,784,252	.9

* Average of balances at beginning and end of year.

50. The consistency apparent in the ratio of write-offs to average outstandings since 1957 indicates that

consumer loan companies have maintained sound credit standards and collection policies despite increasing competition. It does, however, appear inevitable that losses will increase as growth in the use of credit and in the variety and number of credit plans and agencies increases the complexity of credit investigation.

COMPETITION

51. Competition among consumer loan companies as well as from other kinds of lenders has increased during the years since World War II because of increased public demand for consumer credit service and the post-war growth of the economy.

52. After the conclusion of World War II veterans returned to civilian life with a consequently high rate of new family formation which led to a boom in house building and the need for furniture, appliances, automobiles and other durables. Canadian industries quickly converted from production of the needs of war to the needs of peace. Production, employment and spending reached record highs in an economy which inspired confidence in the ability of the average family to buy today and pay tomorrow.

53. Consumer lenders expanded in numbers and size as the economy expanded and established branches in many areas whose residents had theretofore been forced to commute to larger adjacent cities to obtain cash credit. Table 15 shows the growth in number of licensees and number of branch offices for the period 1947 to 1960 to illustrate the growth within the consumer

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loans industry itself. Table 16 shows the growth of this industry in relation to competition from other kinds of lenders to the extent that figures are available.

TABLE 15

Year	Number of Licensees	Number of Operating Branch Off
1947	59	Not Available
1948	61	"
1949	59	"
1950	60	"
1951	61	"
1952	63	"
1953	62	"
1954	65	590
1955	70	747
1956	75	828
*1957	79	836
1958	79	892
1959	81	979
1960	80	1,074

* First year of increase of limit of Small Loans Act from $500 to $1,500.

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* First year of increase of limit of Small Loans Act from $500 to $1,500.

TABLE 16

Year	Small Loans Licensee Branches	% of Total	Number of Credit Unions	% of Total	Bank Branches	% of Total
1947	Not Available	-	2,516	-	3,456	-
1948	"	-	2.608	-	3,551	-
1949	"	-	2,819	-	3,648	-
1950	"	-	2,965	-	3,766	-
1951	"	-	3,121	-	3,867	-
1952	"	-	3,333	-	3,951	-
1953	"	-	3,606	-	4,047	-
1954	590	6.8	3,920	45.1	4,180	48.1
1955	747	8.2	4,100	44.5	4,359	47.3
1956	828	8.6	4,258	44.3	4,524	47.1
1957	836	8.5	4,349	44.2	4,664	47.3
1958	892	8.8	4,485	43.9	4,819	47.3
1959	979	9.3	4,570	43.3	5,020	47.4
1960	1,074	9.8	4,667	42.7	5,204	47.5

54. Table 3 (page 15) demonstrates that the outstandings of the consumer loan industry have shown a steady increase during the years since World War II despite the marked growth in the number of outlets of competitive services. This is strong evidence that the industry offers lending service suited to the needs of a substantial proportion of the Canadian public. Since consumer loan companies cannot match the rates offered by their principal competitors it must be concluded that their service, their collection practices and their credit qualification standards are such as to attract borrowers whether they are eligible to borrow from other lenders or not.

55. Many consumers set significant values upon convenience and continuing relationships with those in whom they have confidence and also the environment in which they do business. In general they tend to seek out the lender whose eligibility requirements they can meet.

IMPACT OF CREDIT CONTROLS

56. Prior to the beginning of World War II there was no serious discussion about limitations on the extent of the use of consumer credit, down payments or terms in sales finance transactions nor on terms or purposes of consumer loans. When Canada entered in War in 1939, several emergency measures were taken by the Federal Government. Two primary objectives of these measures which became important in a time of national crisis were:

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(1) To divert the productive capacity of the country into the production of armament and war goods; and

(2) To curtail consumer demand for goods and direct the maximum portion of consumer assets and incomes into financing the war effort.

To achieve these objectives restrictions were placed on the use of strategic materials so that they would be directed into war production. Price controls, wage controls and food rationing were instituted.

57. To curtail consumer demand for goods the Wartime Prices and Trade Board, commencing in October, 1941, promulgated a series of orders restricting the use of consumer credit and culminating in Order 225 which became effective January 18, 1943. Order 225, which was to serve for the following four years, brought all commodities with few minor exceptions, under credit control. The maximum term of payment was ten months when the amount financed was under $500 and fifteen months for amounts over $500. The minimum down payment on all goods was set at one-third of the retail price and all charge accounts were to be paid by the 25th of the month following that in which the goods were purchased. Similar restrictions were applied to loans secured by goods previously purchased by the borrower and loans to be used for the purchase of goods. Such loans could not exceed two-thirds of the value of the goods and the terms of repayment were required to conform with the terms of payment set out for credit advanced in connection with the purchase of goods.

58. After the end of World War II Order 225 was retained as an anti-inflationary control while consumer durables were still in short supply and the nation's productive facilities were being reconverted from war production to production of consumer goods. It was ultimately revoked in January, 1947.

59. With the advent of the Korean War in 1950, consumer credit once again came under regulation in October of that year and remained under regulation until May, 1952. At the outset down payments of one-third of the purchase price were required on motor vehicles and one-fifth on other restricted goods while maximum term of payment permitted was 18 months. The regulations were amended several times so that by the time they were revoked in May, 1952, the down payment for motor vehicles was one-half and for other restricted goods one-third while maximum term was 12 months. Loans for the purchase of restricted goods had to conform to these requirements while charge accounts, revolving credit plans and contracts for hire also came under regulation. Specifically exempted from regulation were loans made for agricultural purposes on the security of agricultural equipment, loans secured by real estate mortgages, stocks, bonds, debentures or insurance policies and loans made by pawnbrokers on the security of goods pawned. The consumer loan companies have had experience with this kind of control in both wartime and peacetime. While the control was designed primarily to limit market demand for durable goods, it tended to do so at the expense of a particular economic

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group.

60. In any discussion of credit controls it is important to have in mind the radically different character of the two principal kinds of credit -- goods credit and cash or loan credit. Goods credit adds effective purchasing power to the demand for consumer goods and hence is a significant economic factor. Its restriction dampens the demand for specific consumer goods by rationing those goods to people having cash or liquid assets and the willingness to use them.

61. Loans by licensees represent only a small fraction of the total consumer debt (14% at the end of 1961). Because of their remedial nature, however, such loans are vitally important to wage and salary earners and their families. Most of such persons and families are dependent on wages and salaries. If their periodical income is interrupted or if they face the need for a large cash outlay they must turn to credit. The instalment cash loan is their only means of adjustment to financial problems arising through interrupted income, emergencies or changed conditions.

62. Their financial problems take the form of an accumulation of small debts to landlords, merchants, utilities and other creditors; or a sudden emergency like sickness or death; or a chance at improvement like moving elsewhere for a new job. Remedial loans provide the only means the average family has to keep on a stable footing or, being in debt, to get out systematically. The wage system has created the necessity for such loans as a means of stabilizing the money income and outgo of

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the family. To restrict these instalment cash loans unduly would create hardship for thousands of families. Such loans should be fostered in times of economic change and stress because at such times the need for them increases. The only reason to regulate them at any time is to prevent their being used in order to avoid restrictions on instalment sale credit if such restriction becomes necessary.

PERSONNEL

63. The companies which make up the membership of the Canadian Consumer Loan Association employ 2,670 male and 2,049 female employees. The annual payroll for the industry in 1960 was $17,481,285. In addition to salary, most companies contribute towards the cost of major medical expenses, group life insurance and pension plans. The largest company in the business reports its average hiring age for male employees is 22 years -- it takes the average man about five years to achieve manager status. Throughout their training period employees' progress is regularly reviewed by supervisors. After assignment to the first branch as manager, the line of promotion continues through larger and more complex branch offices to supervisory and executive levels.

64. Many of the companies employ district supervisors who have graduated from the rank of branch manager. Supervisors visit the branches frequently to ensure that sound lending procedures and fair collection practices are adhered to. Their experience is invaluable in the continuous training program which

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63. The companies which make up the membership of the Canadian Consumer Loan Association employ 2,670 male and 2,049 female employees. The annual payroll for the industry in 1960 was $17,431,235. In addition to salary, most companies contribute towards the cost of major medical expenses, group life insurance and pension plans. The largest company in the business reports its average hiring age for male employees is 22 years -- it takes the average man about five years to achieve manager status. Throughout their training period employees' progress is regularly reviewed by supervisors. After assignment to the first branch as manager, the line of promotion continues through larger and more complex branch offices to supervisory and executive levels.

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65. Individual companies and the Association as a whole have spent many thousands of dollars developing motion pictures, manuals, and other training media to ensure that their personnel will be fully instructed in all phases of the business.

FINANCIAL OPERATIONS

66. This section is based on information supplied by 26 companies representing 95% of the business conducted in Canada under the Small Loans Act. The information was prepared by the chartered accountants firm of Deloitte, Plender, Haskins & Sells, as the result of a questionnaire sent to the Association members. The questionnaire requested information relating to members' activities and experiences in dealing with chartered banks and other sources of money. Twenty-six replies were received that could be used fully. Tables 17 to 24, which appear following page 33 contain this and other relevant invormation.

67. Table 17 divides the companies into three size groups and also classifies them as to Canadian-controlled and foreign-controlled. Table 18 shows the twenty-six companies classified by size and by type of control and shows the growth of each classification during the years 1950 to 1960. It can be seen from this table that the rate of growth of Canadian-controlled companies has been much greater than that of foreign-controlled companies. It is also apparent that the group B, or the medium size companies, have experienced a much

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greater rate of growth than either of the other two groups.

68. Table 19 shows, for the twenty-six companies, the source and application of funds for the ten years, based upon the Department of Insurance Reports for December 31, 1950 and 1960.

69. It will be seen that a very large part of the increase in loans outstanding is represented by a corresponding increase in borrowed money.

PERCENTAGE OF INCREASE IN LOANS OUTSTANDING PROVIDED BY INCREASE IN BORROWED MONEY

GROUP A	-	87.7%
GROUP B	-	89.2%
GROUP C	-	65.3%

70. Tables 20 and 21 show the analysis of funds (total of borrowed money and equity) for the twenty-six companies, at December 31, 1950 to 1960 inclusive. It is evident that, especially in Groups A and B, a large part of the borrowed money is obtained from affiliates. In answer to a query as to specific borrowing made by affiliates for the use of the licensed company, a few companies reported some such borrowings but in general the funds borrowed from affiliates were an indistinguishable part of the overall resources of the parent and related enterprises.

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PERCENTAGE OF INCREASE IN LOANS OUTSTANDING PROVIDED BY INCREASE IN BORROWED MONEY

GROUP A	-	37.7%
GROUP B	-	39.2%
GROUP C	-	65.7%

70. Tables 20 and 21 show the analysis of funds (total of borrowed money and equity) for the twenty-six companies, at December 31, 1950 to 1960 inclusive. It is evident that, especially in Groups A and B, a large part of the borrowed money is obtained from affiliates. In answer to a query as to specific borrowing made by affiliates for the use of the licensed company, a few companies reported some such borrowings but in general the funds borrowed from affiliates were an indistinguishable part of the overall resources of the parent and related enterprises.

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affiliates by the particular licensed companies in these "families" is shown to give an indication of their participation in the funds. These companies represent 86% of the total borrowed from affiliates at December 31, 1960, as shown on Tables 20 and 21. As Tables 20 and 21 indicate, the main sources of funds (to the licensed companies) were chartered banks, affiliates and equity. From Tables 22 and 23, it can be seen, however, that indirectly a significant part of the funds were obtained through long-term and short-term borrowings.

72. Tables 22 and 23 show that the three foreign-controlled enterprises operated to a much larger extent on equity (that is, invested capital plus retained earnings) than did the six Canadian-controlled enterprises. In the years after 1951, there is a larger share of the funds provided through long-term documents for the foreign-controlled companies compared with the Canadian-controlled companies.

73. In the questionnaire to the Association members, a request was made for comments and details concerning experience in the money markets. Although few of the licensed companies had a direct involvement in these markets, the experiences of affiliated companies were reported on by some respondents.

74. There appears to have been developed a short-term money market in which the larger Canadian borrowers (whether controlled in Canada or elsewhere) can secure funds on terms and at rates attractive to them. However, where the borrowing is to be done, for various reasons, by a company located outside of Canada, the market is less

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attractive, perhaps because of the increased cost due to taxes and other "border" costs, or because they have not developed a place in the Canadian market which can compete with their domestic sources.

75. The rate of interest paid for short-term money ranged considerably, depending on the size of the company and its activity in the market. Some companies consistently paid under the bank prime rate while others, especially the small ones, paid very high rates.

76. The funds borrowed on short-term instruments were regularly renewed, and in the main if one source of such money became unavailable or unattractive, the companies were able during this ten year period to switch their attention to other sources in the short-term market or to long-term money or to foreign sources. While this was somewhat more difficult for the smaller companies, the larger companies had no difficulty in this, although there was usually an increased cost. A Canadian-controlled company indicated that they are able to obtain the relatively large amounts of money they need in Canada. They do this through a Canadian parent that uses bank, short-term and long-term sources.

77. One foreign-controlled company, due to indenture restrictions on the parent, can borrow only from affiliates. The parent company has several times attempted to sell large quantities of Canadian dollar securities to Canadian institutions but has not been able to do so to the extent desired and has found it necessary to sell these same Canadian dollar securities to insti-

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78. Following the 1959 bank restrictions, one Canadian-controlled company decided to reduce its dependence on bank credit and issued short and long term obligations in Canadian and U.S. dollars. The company expressed, in their questionnaire, the opinion that as a Canadian company they should be able to meet their requirements through the Canadian capital markets with Canadian funds. As they did not do so, it is clear they felt they could not do so.

79. A large foreign-controlled company whose officers are in Canada informed us that in their opinion the officers of their company were better able to sell privately the company's obligations than were investment dealers, although they did obtain some information from dealers.

80. One company that places its short-term notes privately itself, remarked that it has invested its own occasional surplus funds in the short-term market through investment dealers, and has found them well informed and helpful. In several cases, due to indenture restrictions on the parent, borrowings were made in Canadian dollars by a foreign parent for the use of the licensed subsidiary. These borrowings were mainly from Canadian chartered banks and on long-term issues.

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82. There was no pattern reported of requirements by banks lending money for a periodic clean-up of loans or for the maintenance of a certain balance on deposit or for a certain percentage of total borrowings to be allocated to the bank. There were isolated cases of minimum deposit requirements but these were not important relative to bank borrowings of the industry. As a general practice, the larger companies are not required to pledge collateral on bank loans, although some companies in Groups B and C reported that they did so.

83. The members were asked for the following information:

> "If your company experienced during the period December 31, 1950, to December 31, 1960, a sudden drop in a line of credit or if demand paper was suddenly called, give the circumstances and indicate what new source of credit was obtained and the general effect on the cost of money to you."

Some companies replied that they had had such experience only as a result of their own business conditions. Others, however, replied in terms that made it clear that restrictions had been applied by all of the chartered banks at cer-

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84. In times of limited credit at the banks, the larger companies found no difficulty in obtaining money elsewhere, although often at increased cost. The smaller companies, especially some of the independent Canadian companies, reported that the 1959 line freeze had a severe impact on them. Several were not able to obtain money elsewhere on suitable terms and slowed their growth or shrank. One large company stated that lines of credit with Canadian banks were not dependable as a permanent source of money. They have, therefore, not relied on such lines for long-term purposes. One company noted that the 1959 restriction had the effect of requiring them to reduce their bank borrowings faster than collections were realized on receivables. They therefore had to obtain funds outside of Canada at increased cost.

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35. A Canadian-controlled company in Group B indicated that when bank credit was restricted in 1959, had just undertaken an expansion programme. They were

forced to limit growth even though new offices had been opened, and to borrow short-term money at 8%. Some smaller companies, usually paying 6% at the bank, reported no drop in their line of credit. The bank lines of others in the same circumstances were frozen in 1959. These companies raised the funds needed either internally or with modest borrowings. A small Canadian company that had been paying the prime rate, reported that the 1959 restriction halted their slow, steady growth as they were not able to obtain a new source of credit except at increased rates which were considered unprofitable. One large company stated that the 1959 bank restriction caught them during a period of planned growth. They were forced to borrow long-term money in the U.S. at increased cost and were exposed to exchange rate uncertainties.

86. A Canadian company in Group B indicated that the 1959 restrictions temporarily limited new loans made until new sources of money were obtained. The cost of their money reached a high of 7¼% whereas only a few weeks earlier this money had been available at rates of 3% to 3½%. Another Canadian company in Group B indicated that as a result of the 1959 restrictions they virtually stopped lending until the bank loan had been reduced. This particular company was given six months to reduce their bank borrowings by about 20%.

87. One foreign-controlled company reported that in August of 1959 they were restricted to the amount borrowed August 14, resulting in a reduction in their line of 67%. This followed on a May restriction (to the highest amount used in 1958) which had reduced their line

by 40%. They remarked as to the August restriction that at the time their borrowings from banks were being kept low, at the expense of higher interest cost in the short-term market (30 day money was commanding 6½% on August 18), in an attempt to help their bankers over a very difficult time. If the following Monday had been selected for the very arbitrary action, the lines would have been nearly doubled. Their solution was an additional private offering of long-term notes, supplemented by a temporary loan from their parent company. The effect was an increase in the average cost of money.

TABLE IV

ANALYSIS OF LOANS OUTSTANDING AT DECEMBER 31 - 1960

DOLLARS

	Number of Companies	Small Loans		All Other Loans
		Number of Accounts	Dollars Outstanding	Dollars Outstanding
Twenty-six companies analyzed			(000's)	(000's)
A (more than $10,000,000 outstanding)	5	810,986	$334,032	$ 81,123
B ($500,000 to $10,000,000 outstanding)	10	94,160	37,814	35,764
C (under $500,000 outstanding)	11	6,994	2,197	1,136
Total	26	912,140	$374,043	$118,023
All other companies	54	45,825	17,505	25,786
TOTAL (all licensed companies)	80	957,965	$391,548	$143,809
Twenty-six Companies Classified as to Canadian or Foreign Control				
Canadian-controlled	19	221,476	$ 87,077	$ 77,957
Foreign-controlled	7	690,664	286,966	40,166
Total	26	912,140	$374,043	$118,023

PERCENTAGES

	Number of Companies	Small Loans		All Other Loans
		Number of Accounts	Dollars Outstanding	Dollars Outstanding
Twenty-six companies analyzed	%	%	%	%
A (more than $10,000,000 outstanding)	6.3	84.7	85.3	56.4
B ($500,000 to $10,000,000 outstanding)	12.5	9.8	9.7	24.9
C (under $500,000 outstanding)	13.7	.7	.6	.8
Total	32.5	95.2	95.6	82.1
All other companies	67.5	4.8	4.4	17.9
TOTAL (all licensed companies)	100.0	100.0	100.0	100.0
Twenty-six Companies Classified as to Canadian or Foreign Control				
Canadian-controlled	73.1	24.3	23.3	66.0
Foreign-controlled	26.9	75.7	76.7	34.0
Total	100.0	100.0	100.0	100.0

The 26 companies analyzed have 95.2% of the number and 95.6% of the dollar value of small loans outstanding for all licensed companies.

TABLE 18

CANADIAN CONSUMER LOAN ASSOCIATION
SMALL LOAN BALANCES (THOUSANDS OF DOLLARS)
DECEMBER 31, 1950 TO 1960

	Analysis of Twenty-six Companies					Total of Twenty-six Companies	All Other	All Licensed Companies
	Canadian Controlled	Foreign Controlled	By Size A	B	C			
1950	$ 5,632	$ 49,519	$ 51,723	$ 2,898	$ 530	$ 55,151	$ 3,456	$ 58,607
1951	7,264	58,576	62,119	3,175	546	65,840	3,420	69,260
1952	8,738	64,878	69,640	3,444	532	73,616	3,374	76,990
1953	9,249	69,108	74,089	3,726	542	78,357	3,483	81,840
1954	10,832	74,261	79,878	4,481	734	85,093	3,730	88,823
1955	12,056	72,210	77,841	5,639	786	84,266	4,579	88,845
1956	13,278	70,350	75,682	7,184	762	83,628	4,800	88,428
*1957	42,930	172,511	194,367	19,527	1,547	215,441	13,759	229,200
1958	57,532	243,462	272,207	26,919	1,868	300,994	14,834	315,828
1959	71,226	272,531	309,493	32,084	2,180	343,757	16,263	360,020
1960	87,077	286,966	334,032	37,814	2,197	374,043	17,505	391,548
Expressed as a percentage of the previous year:								
1951	129	118	120	110	103	119	99	118
1952	120	111	112	108	97	112	99	111
1953	106	107	106	108	102	106	103	106
1954	117	107	108	120	135	109	107	109
1955	111	97	97	126	107	99	123	100
1956	110	97	97	127	97	99	105	100
*1957	323	245	257	272	203	258	287	259
1958	134	141	140	138	121	140	108	138
1959	124	112	114	119	117	114	110	114
1960	122	105	108	118	101	109	108	109

*Exaggerated indication of growth due to increase in limit of Small Loans Act from $500 to $1,500 at January 1, 1957.

NOTE: The companies are analyzed into Groups A, B and C on the basis of Small Loans outstanding at December 31, 1960:

Group A - over $10,000,000 outstanding.
Group B - over $500,000 but under $10,000,000 outstanding.
Group C - under $500,000 outstanding.

TABLE 19

CANADIAN CONSUMER LOAN ASSOCIATION
TWENTY-SIX COMPANIES
SOURCE AND APPLICATION OF FUNDS (THOUSANDS OF DOLLARS)
DECEMBER 31, 1950 TO DECEMBER 31, 1960

	A	B	C
Source:			
Profits after taxes	$ 67,638	$ 3,157	$ 656
Add provision for bad and doubtful accounts	6,011	1,244	126
	73,649	4,401	782
Increase in borrowed money	297,727	57,335	1,158
New issues of capital stock	25,132	4,129	361
Changes in other assets and liabilities plus sundry unaccounted changes in surplus and reserves	3,148	(1,193)	(146)
Total	$399,656	$64,672	$2,155
Application:			
Increase in loans outstanding:			
Small	$282,309	$34,916	$1,667
Other (net of unearned charges)	57,176	29,337	106
	339,485	64,253	1,773
Dividends and withdrawals	60,171	419	382
Total	$399,656	$64,672	$2,155

NOTE: The companies are analyzed into Groups A, B and C on the basis of Small Loans outstanding at December 31, 1960:

Group A - over $10,000,000 outstanding.
Group B - over $500,000 but under $10,000,000 outstanding.
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TABLE 20

CANADIAN CONSUMER LOAN ASSOCIATION
TWENTY-SIX COMPANIES
ANALYSIS OF FUNDS AT DECEMBER 31 (THOUSANDS OF DOLLARS)

		Chartered Banks $	Short-Term $	Long-Term $	Affiliates $	Total Borrowed $	Equity $	Total $
A:	1950.............	3,289			51,727	55,016	8,914	63,930
	1951.............	10,325			58,693	69,018	9,364	78,382
	1952.............	19,979	250		68,441	88,670	11,045	99,715
	1953.............	18,035	165		70,681	88,881	26,003	114,884
	1954.............	12,579	365		89,030	101,974	28,765	130,739
	1955.............	27,190			91,232	118,422	31,518	149,940
	1956.............	25,348			117,867	143,215	26,571	169,786
	1957.............	20,500			180,809	201,309	31,285	232,594
	1958.............	35,650			225,362	261,012	38,245	299,257
	1959.............	35,700	750		278,851	315,301	37,321	352,622
	1960.............	42,017	1,250		309,476	352,743	41,431	394,174
B:	1950.............	54			2,794	2,848	1,716	4,564
	1951.............	24			2,843	2,867	1,861	4,728
	1952.............	12			3,759	3,771	1,945	5,716
	1953.............	261		48	4,558	4,867	2,310	7,177
	1954.............	233		71	5,938	6,242	2,627	8,869
	1955.............	389		71	11,529	11,989	4,123	16,112
	1956.............	482		105	23,443	24,030	4,953	28,983
	1957.............	803		120	29,177	30,100	5,998	36,098
	1958.............	793		229	39,100	40,122	6,862	46,984
	1959.............	1,475	159	304	51,533	53,471	7,726	61,197
	1960.............	1,222	214	382	58,364	60,182	8,584	68,766
C:	1950.............	795		62	121	978	303	1,281
	1951.............	746		62	112	920	343	1,263
	1952.............	823		62	126	1,011	426	1,437
	1953.............	908	6	62	150	1,126	476	1,602
	1954.............	778		62	169	1,009	574	1,583
	1955.............	962		62	185	1,209	683	1,892
	1956.............	1,252		62	332	1,646	737	2,383
	1957.............	1,489	29	62	367	1,947	815	2,762
	1958.............	1,908	10	62	474	2,454	827	3,281
	1959.............	1,510		90	706	2,306	896	3,202
	1960.............	1,383	20	90	643	2,136	944	3,080

TABLE 21

CANADIAN CONSUMER LOAN ASSOCIATION
TWENTY-SIX COMPANIES
ANALYSIS OF FUNDS AT DECEMBER 31 (PERCENTAGES)

		Chartered Banks %	Short-Term %	Long-Term %	Affiliates %	Total Borrowed %	Equity %
A:	1950	5.1			80.9	86.0	14.0
	1951	13.2			74.9	88.1	11.9
	1952	20.0	.3		68.6	88.9	11.1
	1953	15.7	.2		61.5	77.4	22.6
	1954	9.6	.3		68.1	78.0	22.0
	1955	18.1			60.9	79.0	21.0
	1956	14.9			69.4	84.3	15.7
	1957	8.8			77.7	86.5	13.5
	1958	11.9			75.3	87.2	12.8
	1959	10.1	.2		79.1	89.4	10.6
	1960	10.7	.3		78.5	89.5	10.5
B:	1950	1.2			61.2	62.4	37.6
	1951	.5			60.1	60.6	39.4
	1952	.2			65.8	66.0	34.0
	1953	3.6		.7	63.5	67.8	32.2
	1954	2.6		.8	67.0	70.4	29.6
	1955	2.4		.4	71.6	74.4	25.6
	1956	1.7		.3	80.9	82.9	17.1
	1957	2.2		.4	80.8	83.4	16.6
	1958	1.7		.5	83.2	85.4	14.6
	1959	2.4	.3	.5	84.2	87.4	12.6
	1960	1.8	.3	.5	84.9	87.5	12.5
C:	1950	62.1		4.8	9.4	76.3	23.7
	1951	59.0		4.9	8.9	72.8	27.2
	1952	57.3		4.3	8.8	70.4	29.6
	1953	56.7	.4	3.9	9.3	70.3	29.7
	1954	49.1		3.9	10.7	63.7	36.3
	1955	50.8		3.3	9.8	63.9	36.1
	1956	52.6		2.6	13.9	69.1	30.9
	1957	53.9	1.1	2.2	13.3	70.5	29.5
	1958	58.2	.3	1.9	14.4	74.8	25.2
	1959	47.2		2.8	22.0	72.0	28.0
	1960	44.9	.6	2.9	20.9	69.3	30.7

TABLE 22

CANADIAN CONSUMER LOAN ASSOCIATION
ANALYSIS OF FUNDS OF CONSOLIDATED PARENTS OF NINE LICENSED COMPANIES
(THOUSANDS OF DOLLARS)

	Chartered Banks $	Short-Term $	Long-Term $	Equity $	Total $	Borrowed by Licensed Company from Affiliates $
Six Canadian-Controlled:						
1950	68,065	3,000	116,773	28,143	215,981	6,729
1951	32,855	59,837	125,616	31,195	249,503	7,183
1952	106,564	93,669	131,530	50,797	382,560	10,440
1953	120,153	115,438	164,632	65,534	465,757	10,118
1954	63,162	78,233	190,623	76,772	408,790	15,252
1955	130,450	122,836	186,315	91,288	530,889	19,985
1956	138,260	194,450	238,190	107,605	678,505	31,451
1957	114,533	193,820	285,025	114,966	708,344	35,930
1958	147,084	137,037	299,821	126,899	710,841	27,536
1959	162,027	234,212	316,200	135,948	848,387	49,188
1960	149,438	339,273	405,645	153,440	1,047,796	66,944
Three Foreign-Controlled:						
1950	Included in Short-Term as detail of bank borrowings was not available.	146,946	148,585	153,082	448,613	47,327
1951		147,750	224,609	164,097	536,456	53,018
1952		124,940	280,306	187,341	592,587	59,941
1953		98,743	360,936	208,467	668,146	63,131
1954		118,827	369,171	221,851	709,849	77,780
1955		317,881	517,004	280,210	1,115,095	78,482
1956		330,616	652,295	308,747	1,291,658	100,147
1957		313,247	761,940	340,528	1,415,715	159,979
1958		356,337	739,770	365,593	1,461,700	214,388
1959		371,578	879,881	397,906	1,649,365	247,714
1960		352,857	1,029,074	422,982	1,804,913	250,972

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TABLE 23

CANADIAN CONSUMER LOAN ASSOCIATION
ANALYSIS OF FUNDS OF CONSOLIDATED PARENTS OF NINE LICENSED COMPANIES
(PERCENTAGES)

	Chartered Banks %	Short-Term %	Long-Term %	Equity %	Total %	Borrowed by Licensed Company from Affiliates %
Six Canadian-Controlled:						
1950	31.5	1.4	54.1	13.0	100.0	3.1
1951	13.2	24.0	50.3	12.5	100.0	2.9
1952	27.9	24.5	34.4	13.2	100.0	2.7
1953	25.8	24.8	35.3	14.1	100.0	2.2
1954	15.5	19.1	46.6	18.8	100.0	3.7
1955	24.6	23.1	35.1	17.2	100.0	3.8
1956	20.4	28.6	35.1	15.9	100.0	4.6
1957	16.2	27.4	40.2	16.2	100.0	5.1
1958	20.7	19.3	42.2	17.8	100.0	3.9
1959	19.1	27.6	37.3	16.0	100.0	5.8
1960	14.3	32.4	38.7	14.6	100.0	6.4
Three Foreign-Controlled:						
1950	Included in Short-Term as detail of bank borrowings was not available.	32.8	33.1	34.1	100.0	10.5
1951		27.5	41.9	30.6	100.0	9.9
1952		21.1	47.3	31.6	100.0	10.1
1953		14.8	54.0	31.2	100.0	9.4
1954		16.7	52.0	31.3	100.0	11.0
1955		28.5	46.4	25.1	100.0	7.0
1956		25.6	50.5	23.9	100.0	7.8
1957		22.1	53.8	24.1	100.0	11.3
1958		24.4	50.6	25.0	100.0	14.7
1959		22.5	53.4	24.1	100.0	[illegible]
1960		19.6	57.0	23.4	100.0	13.9

TABLE 24

CANADIAN CONSUMER LOAN ASSOCIATION
TWENTY-SIX COMPANIES
BANK LINE AND BALANCE OUTSTANDING (THOUSANDS OF DOLLARS)
DECEMBER 31, 1950 TO 1960

	A			B			C		
	Line	Balance	% in Use	Line	Balance	% in Use	Line	Balance	% in Use
1950	$ 9,990	$ 3,289	33	$ 55	$ 54	98	$1,025	$ 795	77
1951	11,325	10,325	91	25	24	96	1,020	746	73
1952	24,730	19,979	81	13	12	92	1,115	823	74
1953	30,540	18,035	59	336	261	78	1,050	908	86
1954	30,580	12,579	41	382	233	61	1,125	778	69
1955	35,895	27,190	76	528	389	74	1,335	962	72
1956	29,000	25,348	87	551	482	87	1,715	1,252	73
1957	28,600	20,500	72	818	803	98	1,875	1,489	79
1958	55,650	35,650	64	896	793	88	2,285	1,908	84
1959	49,055	35,700	73	1,480	1,475	99	1,672	1,510	90
1960	55,370	42,017	76	1,270	1,222	96	1,607	1,383	86

APPENDIX "A"

CANADIAN CONSUMER LOAN ASSOCIATION

CODE OF ETHICS & BUSINESS STANDARDS

(a) Members will explain fully to customers the actual cost, terms and contractual obligations of loan transactions.

(b) Members will use in all loan transactions written instructions worded in as simple, lucid, and unambiguous language as circumstances will permit and will draw such instruments with a view to the bona fide application of these standards of business conduct.

(c) No Member shall take any note, promise to pay or security that does not accurately disclose the actual amount of the loan, the time for which it is made and the agreed rate of charge, nor any instrument in which blanks are left to be filled in after execution.

(d) Every Member shall, if so requested by the borrower, deliver to the borrower at the time any loan is made, an exact copy of any note, loan contract, chattel mortgage, lien agreement or wage assignment, signed by the borrower.

(e) Every Member shall give to the borrower on demand a plain and complete receipt for all payments made, specifying the amount applied to loan charges and the amount, if any, applied to principal, and stating the unpaid principal balance, if any, of

such loan.

(f) Upon payment by a borrower of his indebtedness in full, every Member shall mark indelibly such evidence of indebtedness signed by the borrower with the word "Paid" or "Cancelled", restore any pledge, return any notice or loan contract or assignment given to the Member by the borrower and upon request release any mortgage.

(g) Every Member shall display in each place of business a full and accurate schedule of the charges to be made and the method of computing same.

(h) Members will endeavour to transact all business in such manner as to merit the respect and confidence of customers and the public.

(i) Members will avoid unduly harsh or oppressive collection methods and, except in very special cases, will resort to legal process for collection only in the event of misrepresentation, fraud, or refusal to comply with the terms of the contract.

(j) Members will adhere to the generally accepted standards of business deportment in competitive relations, in advertising, and in their dealings with the public.

(k) The Members agree to take advantage of opportunities to explain the Small Loans business frankly and fearlessly to the general public, business men, public officials, the press, legislators and others who create public opinion.

such loan.

(f) Upon payment by a borrower of his indebtedness in full, every Member shall mark indelibly such evidence of indebtedness signed by the borrower with the word "Paid" or "Cancelled", restore any pledge, return any notice or loan contract or assignment given to the Member by the borrower and upon request release any mortgage.

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(j) Members will adhere to the generally accepted standards of business deportment in competitive relations, in advertising, and in their dealings with the public.

(k) The Members agree to take advantage of opportunities to explain the Small Loans business frankly and fearlessly to the general public, business men, public officials, the press, legislators and others who create public opinion.

APPENDIX "B"

CANADIAN CONSUMER LOAN ASSOCIATION MEMBERS

JUNE 1962

NAME	No. of BRANCHES
Associates Budget Plan Ltd.	19
Astre Finance Company Ltd.	1
H. Bell Finance Limited	1
Beneficial Finance Company of Canada	159
Bradley Finance Company Ltd.	3
Budget Financing Limited	1
Canadian Personal Loan & Finance Inc.	1
Capital Finance Ltd.	1
Canadian Acceptance Company	49
Citizens Finance Company Ltd.	22
Clifton Finance Company Ltd.	1
Community Finance Corporation	27
Cosmopolitan Finance Ltd.	1
Crescent Finance Corporation Ltd.	88
Custom Finance Ltd.	1
Danforth Finance Company	1
Dollar Finance Corporation Ltd.	1
Don Finance Company Ltd.	1
Excel Finance Corporation Ltd.	1
Fairway Finance Corporation Ltd.	3
Friendly Finance Corporation Ltd.	1
General Finance Company Ltd.	1
General Finance Corporation Ltd.	1
Globe Mortgage & Loan Company Ltd.	1
Household Finance Corporation of Canada	263

Name	No. of BRANCHES
Independent Finance Corporation Ltd.	2
Insurance & Discount Corporation Ltd.	1
Kent Finance Company Limited	1
Laurentide Finance Company	54
Lombank Finance (Eastern) Ltd.	13
Lucerne Finance Corporation Ltd.	5
Marina Finance Company Ltd.	1
Merchants Finance Ltd.	1
National Plan Corporation Ltd.	2
Niagara Finance Company Ltd.	211
O'Neill Finance Company Ltd.	1
Pacific Finance Credit Ltd.	46
Peoples Finance Corporation Ltd.	1
Popular Finance Corporation Ltd.	1
Prudential Family Credit Ltd.	2
Public Finance Corporation Ltd.	2
Reliance Finance Company Ltd.	1
Rideau Finance Corporation Ltd.	1
Schioler & Company	1
Seaboard Finance Company of Canada Ltd.	59
Severn Finance Limited	2
Sterling Finance Corporation Ltd.	1
Superior Finance Ltd.	17
The Toronto Finance Corporation Ltd.	1
Toro Finance Company Ltd.	1
Trans Canada Credit Corporation Ltd.	75
Union Finance Company Ltd.	16
United Dominions Finance Corporation	1
Victory Finance Corporation Ltd.	1

TOTAL MEMBERS -------- 54

TOTAL BRANCHES ------- 1170

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Toronto, Ontario

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LAWFUL MAXIMUM RATES PER MONTH ON DECLINING BALANCES OF DIFFERENT SIZE LOANS

REPAID ACCORDING TO CONTRACT

	RATE	LOAN SIZE				
$1500 Loan Ceiling or Over		$100	$300	$500	$1000	$1500
CANADA	2%-$300; 1%-$1000; ½%-$1500		2.00%	1.81%	1.47%	1.27%
UNITED STATES						
California	2½%-$200; 2%-$500; 5/6%-$5000	2.50%	2.42%	2.29%	1.83%	1.54%
Colorado	3%-$300; 1½%-$500; 1%-$1500	3.00	3.00	2.70	2.07	1.76
Kansas	3%-$300; 5/6%-$2100	3.00	3.00	2.58	1.87	1.56
Maine	3%-$150; 2½%-$300; 1½%-$2500	3.00	2.85	2.54	2.10	1.92
Massachusetts	2½%-$200; 2%-$600; 1¾%-$1000; ¾%-$1500	2.50	2.42	2.29	2.12	1.87
Missouri	2.2%-$500; 2/3%-above	2.22	2.22	2.22	1.78	1.48
Nebraska	3%-$150; 2½%-$300; ¾%-$3000	3.04	2.89	2.43	1.74	1.45
Nevada	Add-on; 9%-$1000; 8% above & fee	3.06	2.78	2.39	1.87	1.65
North Dakota	2½%-$250; 2%-$500; 1¾%-$750; 7/12%-$1000	2.50	2.47	2.35	2.11	1.82
Oregon	3%-$300; 2%-$500; 1%-$1500	3.00	3.00	2.80	2.19	1.85
$1000 Loan Ceiling		$100	$300	$500	$1000	
Alaska	4%-$300; 2½%-$600; 2%	4.05	4.05	3.74	3.14	
Idaho	3%-$300; 2%-$500; 1%	3.00	3.00	2.80	2.19	
Montana	Add-on; 20%-$300; 16%-$500; 12%	2.92	2.92	2.70	2.25	
Washington	3%-$300; 1½%-$500; 1%	3.00	3.00	2.70	2.07	
Wyoming	3½%-$150; 2½%-$300; 1%	3.50	3.20	2.68	1.97	
$800 Loan Ceiling		$100	$300	$500	$800	
Illinois	3%-$150; 2%-$300; 1%	3.00	2.71	2.28	1.89	
Kentucky	Add-on; 20%-$150; 15%-$600; 11%	2.92	2.57	2.43	2.21	
New York	2½%-$100; 2%-$300; ¾%	2.50	2.26	1.92	1.58	
$600 Loan Ceiling		$100	$300	$500	$600	
Arizona	3%-$300; 2%	3.00	3.00	2.80	2.71	
Connecticut	3%-$100; 2%-$300; ¾%	3.00	2.51	2.09	1.93	
Florida	3%-$300; 2%	3.04	3.04	2.84	2.74	
Minnesota	2¾%-$300; 1½%	2.75	2.75	2.50	2.39	
Pennsylvania	3%-$150; 2%-$300; 1%	3.00	2.71	2.28	2.12	
Utah	3%-$300; 1%	3.04	3.04	2.65	2.45	
Virginia	2½%-$300; 1½%	2.54	2.54	2.34	2.24	

	RATE	[illegible]		
$500 Loan Ceiling		$100	[illegible]	$500
Indiana	3%-$150; 2%-$300; 1½%	3.04	2.75	2.40
Iowa	3%-$150; 2%-$300; 1½%	3.04	2.75	2.40
New Jersey	2½%-$300; ½%	2.50	2.50	2.12
$300 Loan Ceiling		$100	$300	
Alabama	3%-$200; 2%	3.00	2.85	
Hawaii	3½%-$100; 2½%	3.55	3.05	
Louisiana	3½%-$150; 2½%	3.55	3.24	
Maryland	3%	3.00	3.00	
Oklahoma	10% per yr. & fee & mo. chg.	3.64	2.64	
Rhode Island	3%	3.04	3.04	
West Virginia	3½%-$150; 2½%	3.50	3.20	
Wisconsin	2½%-$100; 2%-$300; 1%	2.50	2.12	

APPENDIX "H"

DIGEST OF SMALL LOANS ACT

This digest is intended to give the reader a working knowledge of the Act by explaining its composition and by converting the language of its principal provisions into simpler terms. The numbers used in this digest are those of the relative sections of the Act. Where reference is to sections from both Part I and Part II of the Act both section numbers are shown.

Purpose

The purpose of the Act is to limit the charges paid by borrowers of small loans and eliminate the practice of many lenders prior to 1940 of making various charges in addition to the stated interest rate.

Title - An Act respecting Small Loans

1.	Short Title	- Small Loans Act
	Enacted	- May 2, 1939
	Came into force	- January 1, 1940
	Amended	- August 14, 1956
	Amendment came into force	- January 1, 1957

The Superintendent of Insurance is responsible for the administration of the Act.

The Office Consolidation of the Act, combines the original Act and the amendment passed in 1956.

The first portion of the Act is interpretive and defines the following terms:

2. (a) "Cost" of a loan means the whole of the cost of the loan to the borrower whether it is

called interest or anything else.

(c) "Loan" means a loan made by a money-lender or small loans company of not more than $1,500.

(e) "Money-lender" means any person other than a chartered bank or registered pawnbroker who carries on the business of money lending, or advertises himself, or holds himself out in any way, as carrying on that business.

<u>Note</u>: Included are those companies incorporated under provincial legislation such as Niagara Finance and Trans-Canada Credit.

(f) "Small Loans Company" means a company incorporated by special Act of Parliament and authorized to lend money on promissory notes or other personal security and on chattel mortgages.

<u>Note</u>: There are five Small Loans Companies in operation at present, Household, Beneficial, Community, Canadian Acceptance, and Laurentide.

The remainder of the Act is divided into three parts.

Part I covers only the operation of money-lenders.

Part II covers only the operation of Small Loans Companies.

Part III covers both money-lenders and Small Loans Companies and deals with penalties for contravention of the Act and issuance of regulations under the Act.

As far as practical operations are concerned the effects of Parts I and II are identical.

called interest or anything else.

(c) "Loan" means a loan made by a money-lender or small loans company of not more than $1,500.

(e) "Money-lender" means any person other than a chartered bank or registered pawnbroker who carries on the business of money lending, or advertises himself, or holds himself out in any way, as carrying on that business.

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Part III covers both money-lenders and Small Loans Companies and deals with penalties for contravention of the Act and issuance of regulations under the Act.

As far as practical operations are concerned the effects of Parts I and II are identical.

The difference between the two parts is that in Part II the Loan Companies Act is made applicable to Small Loans Companies except for certain provisions which do not relate to their business. This obviates the necessity for prescribing in the Small Loans Act the method of incorporation, duties and powers of the directors, etc., which are all set set out in the Loan Companies Act.

13 (1) Sections 5, 7, 8, 10 and 11 in Part I are made applicable to Small Loans Companies.

Note: These sections refer to licensing, and inspection by the Superintendent of Insurance and other miscellaneous subjects.

Principal Provisions

Rate — The cost of any loan shall not exceed:

3 (2) 2% per month on any part of the balance up to $300.

14 (2) 1% per month on any part of the balance over $300 up to $1,000.

½% per month on any part of the balance over $1,000 up to $1,500.

Maturity — If a loan of $500 or less is made for more than 20 months maturity the maximum rate is 1% per month on the unpaid balance.

3 (3) If a loan of between $500 and $1,500 is made for more than 30 months

14 (3) the maximum rate is 1% per month on the unpaid balance.

The difference between the two parts is that in Part II the Loan Companies Act is made applicable to Small Loans Companies except for certain provisions which do not relate to their business. This obviates the necessity for prescribing in the Small Loans Act the method of incorporation, duties and powers of the directors, etc., which are all set out in the Loan Companies Act.

13 (1) Sections 5, 7, 9, 10 and 11 in Part I are made applicable to Small Loans Companies.

Note: These sections refer to licensing, and inspection by the Superintendent of Insurance and other miscellaneous subjects.

Principal Provisions

The cost of any loan shall not exceed:

2% per month on any part of the balance up to $500.

1% per month on any part of the balance over $500 up to $1,000.

½% per month on any part of the balance over $1 000 up to $1,500.

If a loan of $500 or less is made for more than 20 months maturity the maximum rate is 1% per month on the unpaid balance.

If a loan of between $500 and $1,500 is made for more than 30 months the maximum rate is ½% per month on the unpaid balance.

Repayment Loans shall be repayable in approximately
equal instalments of principal or of principal
6 (1) and cost of loan at intervals of not more than
14 (5)(a) one month.
6 (2) The cost of any loan or any part of it shall
14 (a)(b) not be compounded or deducted in advance.
6 (3) The borrower may repay any loan or any part
14 (5)(c) of it before maturity on any instalment date
without notice bonus or penalty.

Default If any loan remains unpaid after the due date
of the final instalment, as shown in the
6 (1) contract, interest shall be charged at not
14 (5)(a) more than 1% per month on the unpaid balance.

More than one Loan Where a borrower has unpaid loan balance and
the same lender makes a further loan to the
borrower or the borrower's husband or wife
the cost of the two loans shall not exceed
3 (4) the cost of a single loan for the same total
14 (4) amount.

Example 1: Total amount $1,500 or less

Balance of original loan	$700
New Loan	800
Total	$1,500

The cost shall not exceed

2% per month on the first $300 or any part of it
1% per month on the next $700 or any part of it
½% per month on the next $500 or any part of it

Example 2: <u>Total amount over $1,500</u>

Balance of original loan	$800
New Loan	900
Total	$1,700

The cost shall not exceed

2% per month on the first $300 or any part of it

1% per month on the next $700 or any part of it

½% per month on the next $700 or any part of it

<u>Licences</u> A money-lender, the cost of whose loans does not exceed 1% per month on the unpaid balance is not required to obtain a licence.

5 (1) Any other person making loans of $1,500 or less is required to obtain a licence from the Minister of Finance.

5 (2) The Minister of Finance may issue a licence to any person upon being satisfied that the experience, character and general fitness of such person indicate that he will conduct his business with efficiency, honesty and fairness to the borrowers and to the business of money-lending under the Act.

5 (4) The licence expires on March 31 each year but may be renewed from year to year subject to the requirements of experience, character and fitness as set out in the Act.

<u>Inspection</u> Licensees are required to make annual returns to the Superintendent of Insurance and to make their books available for inspection by him

7 or his representatives.

9 The Superintendent of Insurance may also examine the books of any unlicensed lender in order to ascertain whether the Act is being observed.

Royal Commission on Banking and Finance

MR. A. SPROUL

Hearings held at OTTAWA

Vol. 46

Date. September 27,1962

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Toronto, Ont.

ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa, Ontario, on Thursday, September 27th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

* Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

* Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - - - - - -

Mr. H. A. Hampson - Secretary

* Mr. Gilles Mercure - Joint Secretary

* Absent

Ottawa, Ontario,
Thursday,
September 27th, 1962.

--- At 9.18 A.M. the hearing was resumed.

THE CHAIRMAN: We shall now proceed. We have with us this morning Mr. Allan Sproul. He has submitted a statement to the Commission and I understand he does not wish to make any formal remarks at the outset but would prefer that we proceed with questions based on his written statement.

MR. SPROUL: Yes. I should like to thank the Commission for calling me out of the twilight time zone where I live back into the mid-day heat to try and assess some of the problems of today and foresee some of those of tomorrow. I think it is good for my ego if not for my reputation. In defense of my reputation, if you find some lack of precision in what I have written or in what I may say, I remind you that I no longer have an economic research staff at my elbow to review what I intend to say or write and to take the raciness out of my utterances. I was glad to learn that you extend to foreign witnesses the privilege of reviewing the testimony in transcript form, and if possible I should like to avail myself of that privilege.

THE CHAIRMAN: We appreciate very much your presence here today and we have been looking forward to this discussion with anticipation.

COMMISSIONER LEMAN: Mr. Chairman, if I might open with a question of Mr. Sproul. At the beginning of your statement, sir, you list four objectives of monetary policy. In your list you say that the purpose is to promote sustainable economic growth,high levels of production and employment, international balance and price stability. These objectives seem rather orthodox to us, certainly, but there is one thing we have been wondering about and that is whether government, not necessarily the monetary authority alone but those who would try to formulate good economic policy, could sit down and put quantitative measures on these objectives or if they cannot do so.

MR. SPROUL: I do not think they can. The suggestion has been made, for instance, that it might be done by increasing the supply of money at some fixed percentage each year in order to gear the increase in supply of money with the rate of economic growth. It is my opinion that there is no fixed relationship between the supply of money and the rate of economic growth or of the gross national product, that the supply of money and the velocity of the use of money both have to be considered and that a sort of mechanical guide to action to sustainable economic growth is not available to us. I think the same thing applies to fiscal policy and debt management as it enters into this constellation. We have to take a balanced view of all the facts that are available to us, analyse them to the best of our ability, interpret them and then reach a judgment which relies in part upon an estimate of the balance

[illegible] Mr. Chairman, if I might [illegible] with a question [illegible] of the delivery of your statement [illegible] the importance of monetary policy. In your [illegible] that the pound is no [illegible] instrument of production and employment [illegible] policy and fiscal [illegible]. These [illegible] orthodox to us, certainly, but [illegible] we have been [illegible] government not necessarily [illegible] but those who would [illegible] to formulate [illegible] economic policy, could sit down and [illegible] alternative measures to those of [illegible] or if they cannot do so.

MR. [illegible]: I [illegible] The suggestion [illegible] and it aims to [illegible] first percentage [illegible] in order to [illegible] supply of money [illegible] rate of economic growth. It is my [illegible] that [illegible] relationship between the supply of money and the rate of economic growth or of the gross national product, that the supply of money and the velocity of the use of money [illegible] to be considered and that [illegible] of necessity [illegible] to sustainable economic growth [illegible] within the same [illegible] to fiscal policy and [illegible] as it [illegible] consideration [illegible] to have a balanced [illegible] available [illegible] our ability, [illegible] in part [illegible]

between a whole collection of different factors that are part of the economic complex. I do not think we have been able thus far to find a mechanical relationship between credit policy using that general vague term or the supply of money and the rate of sustainable economic growth.

COMMISSIONER LEMAN: Mr. Sproul, is that not a weakness in any kind of an operation, to remain a little too vague? I am not talking in a vacuum. I am talking about a country in particular and some given economic circumstances. Could one not sit down and after looking at all these factors, which you say are numerous, ask himself, "Well, now, what is the sustainable growth we can face in this particular country at this time? What is our objective in price stability? Are we going to call it no change or a little bit of a change"to be satisfied with our mix. It is in that sense I am wondering if we could have quantitative measures of objectives and not just say, "As long as we have reasonable stability here and reasonable rate of growth it is all right." You see, what is a reasonable rate of growth? Try to pinpoint some values of these things.

MR. SPROUL: First on rate of growth I think we have dabbled in statistical analysis of what rates of growth are in a particular economy, but I do not think we are able to state that a sustainable rate of growth over time is 2½ per cent per annum, 3½ per cent per annum, or 4½ per cent per annum. It goes back not merely to the statistics of the past but to

part of the economic complex. I do not think we have been able thus far to find a mechanical relationship between credit policy, that general vague term and the supply of money and the rate of sustainable growth.

COMMISSIONER [illegible]: Mr. Sproul, is that not a weakness in any kind of an operation, to permit a little too vague? I am not talking in a vacuum. I am talking about a country in particular and some given economic circumstances. Could one not sit down and after looking at all these factors, which you say are numerous, ask himself, "Well, now, what is the sustainable growth we can expect in this particular country at this time? What is our objective in price stability? Are we going to permit it to change [illegible] a change" to be satisfied with our [illegible]. It is in this sense I am wondering if we could have quantitative measures of objectives and not just say, "As long as we have reasonable stability here and reasonable rate of growth it is all right." You see, what is a reasonable rate of growth? Try to introduce some values of these [illegible].

MR. SPROUL: Without an area of [illegible], I think we have dabbled in a statistical analysis of the rates of growth are in a particular economy, but I do not think we are able to state that a certain absolute rate of growth over time is 3½ per cent per annum, [illegible] per cent per annum, or [illegible] per cent per annum. I [illegible] back not merely to the statement of the past [illegible]

the incentives of human beings in the present and in the future; how much they are willing to put into the economic system, what their differing values at differing times may be. It is not a statistical fact which would enable you to say, "We should have a rate of $3\frac{1}{2}$ per cent per annum or whatever." I think you can aim at increasing the rate of growth from whatever it has been by whatever governmental measures are available to you, but I do not think you will do yourselves good if you say, "We should have a growth rate of so much and this is what we must have". You should not say, "This is what we must accomplish, no matter what action is necessary to reach that rate of growth." The same thing, I think, applies to credit policy. After having looked at all the information available to you I think there is a certain vagueness left as to what your specific action should be. We used to use terms such as active ease, ease, neutrality, restraint or active restraint. But it is not a mathematical concept.

COMMISSIONER LEMAN: Can you then measure performance or the success of an economic policy from the government's standpoint only in terms of rather vague results such as, "Well, we have had inflation that we do not like, too much of it"? That is about as precise as one can get in measuring past performances.

MR. SPROUL: You mentioned prices and you now speak of inflation. There, of course, we do not aim at stability of all prices. In our sort of

the [illegible]

the future? How much, say, are you willing to get this

the economic system, what costs differing values at

differing times may be. If you [illegible] statistical fact

which would enable you to say, 'We should have a rate

of 5% per year per annum or whatever.' I think you

can aim at increasing the rate of growth than whatever

it has been by whatever governmental measures are avail-

able to you, but I do not think you will do yourself any

good if you say, "We should have a growth rate of so

much and this is what we must have". You should not say,

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[illegible] LEVEL [illegible]

performance on the success of an economic policy from

the government's standpoint, [illegible]

whose results would [illegible] that

we do not like, too much of it? [illegible]

precise as one [illegible] past performance.

MR. [illegible] You mentioned earlier, and you

were [illegible] of inflation. There is, of course, as it were

[illegible] stability of all prices. In one sort of

economy there will be movements in individual prices up and down, we hope, and we aim at stability of prices in the aggregate. When you ask about inflation, I should say we aim at keeping prices in the aggregate steady. The forces in our economies which tend to push up prices will have some effect but if we aim to keep prices steady we will be getting about the proper results that will lead to or contribute to growth in the economy.

COMMISSIONER MACKINTOSH: In all these things, Mr. Sproul, however, is it not true that although we cannot put a number, as Mr. Leman has suggested, on an objective, we do have to make a judgment as to whether the present situation is too much or too little?

MR. SPROUL: Yes. I think so far as the central bank is concerned, for example, there is the constant necessity of making a judgment, whether it is doing too much or too little or just about right. I am only trying to avoid the acceptance of some quantitative measure that will try to tell you it is too much, too little or just right.

Clearly, there will be some [illegible] in individual prices up and down, [illegible], and we can be [illegible] to that.

[illegible]. When you are [illegible], I should say we aim at keeping prices in the aggregate steady. The forces in our [illegible] which tend to push up prices will have some effect but if we aim to keep prices steady we will be getting about the proper measures that will lead to [illegible] growth in the economy.

COMMISSIONER MACINTOSH: In all these things, Mr. Sproul, however, is it not true that although we cannot get a measure, as Dr. [illegible] suggested, an objective, we do have to make a judgment as to whether the present situation is [illegible]

MR. SPROUL: Yes. I think [illegible] that is [illegible] the necessity of making a judgment, whether it is a bit too much or too little or just about right. I am only trying to avoid [illegible] quantitative measure [illegible] you [illegible] is too much [illegible] just right.

I have been conditioned by the setting up of models, showing that you should have a rate of growth of 5 per cent a year when you have only had a $2\frac{1}{2}$ per cent rate over decades, because I think such models are largely exercises in arithmetic which have very little to do with the way an economic system performs.

You can hope and try to do better, but you cannot establish a figure and say, "This is what it ought to be, and if it is not this we are not doing the right things", and government ought to step in and do more than it is doing in order to achieve these numerical objectives.

COMMISSIONER GIBSON: Mr. Chairman, I would like to ask Mr. Sproul one or two questions.

Like the other Commissioners, I have read your memorandum with a great deal of interest and also a good deal of benefit. What I am really asking you for here is an elaboration. On page 3 of your memorandum you talk about how a restrictive monetary policy works. You say there are three ways, chiefly, in which restrictive monetary policy affects demand -- through raising the cost or price of credit; lessening the availability of credit; and altering the expectations of investors and consumers, lenders and borrowers, as to the future course of the economy.

Would you mind developing that a bit and giving us a little more of your ideas on the relative weight of the factors in influencing spending decisions?

MR. SPROUL: Well, take first raising the cost or price of credit. Monetary policy alone does not determine interest rates, unless it is exclusively directed to that purpose, and then it ceases to be a stabilizing, sustainable monetary policy. Interest rates are also determined by the active demand for credit as well as by the supply. The actions of the monetary authority in increasing or reducing bank reserves, and in that way increasing or reducing the available supply of credit, do affect interest rates and the interest rate structure however, and I think that is a significant part of their influence. When policy is restrictive the money supply is restricted as banks sell assets to non-banks in order to take care of the demands for credit which would be coming forward, when a restrictive policy was indicated. As interest rates rise the prices of financial assets decline and the money value of total financial assets declines. The liquidity of the economy is reduced somewhat. Then you come to the lessening of the availability of credit, the non-price rationing of credit.

The banks having begun to liquidate some of their secondary reserves in order to take care of increasing credit demands, begin to look at those demands more closely, to cut down on some borrowers and, perhaps, to reject some credit applications altogether. I think that is even more effective than the change in interest rates.

MR. SPROUL: Well, we first mention the cost or price of credit. Monetary policy alone does not determine interest rates, unless it is exclusively directed to that purpose, and then it ceases to be a stabilizing, sustainable monetary policy. Interest rates are also determined by the active demand for credit as well as by the supply. The actions of the monetary authority in increasing or reducing bank reserves, and in that way increasing or reducing the available supply of credit, do affect interest rates and the interest rate structure, however, and I think that is a significant part of their influence. When policy is restrictive the money supply is restricted as banks sell assets to non-banks in order to take care of the demands for credit which would be coming forward, when a restrictive policy was indicated. As interest rates rise the prices of financial assets decline and the money value of total financial assets declines, the liquidity of the economy is reduced somewhat. Then you come to the lessening of the availability of credit, the non-price rationing of credit.

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Finally, you come to this question of altering expectations.

I think that is most important. I think that affects the spending of all units in the economy -- business units, individual and household units. The expectations and anticipations of what may be the course of income,prices and profits is a very strong factor in making a restrictive policy work.

COMMISSIONER GIBSON: That leads on to my next question, which is: Do you think that modest changes in monetary policy, involving small changes in interest rates and credit, have much effect, or are there circumstances where they can have a perverse effect?

MR. SPROUL: I think they can have substantial effects if you take your action early enough in the period of the cycle in which you are working. If the actions come along late in the economic movement and you are approaching what is a critical area or the crisis point, then drastic action may become necessary.

However, I think that if you can anticipate the needs and requirements of a situation, actions which are modest which result in small changes in interest rates and small changes in the availability of credit, but perhaps in rather substantial changes in anticipations and expectations, can get results without such severe action as will throw the whole economic machine into reverse.

COMMISSIONER GIBSON: Suppose you take

[illegible]

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However, I think that if you can anticipate the needs and requirements of a situation, actions which are [illegible] which result in small changes in interest rates and small changes in the availability of credit, but perhaps in rather substantial changes in sentiment and expectations, [illegible] get results without such severe action as will throw the whole [illegible] [illegible]

COMMISSIONER GIBSON: I suppose you [illegible]

moderate action in the early stages of the development of a boom, do you think there is any danger that such action may lead to people trying to get more money for fear that interest rates are going to go higher and money is going to be less available further on in the future?

MR. SPROUL: I think there is that possibility. There is the other possibility also: that is, will you choke off expansion before it has reached an optimum point, before it has gone as far as desirable and necessary to achieve the goal of sustainable economic growth? The central banker is faced with that judgment: Are we going to induce people to seek more credit now because it may be more expensive later on; or, on the other hand, are we going to choke off an expansive movement we would like to see continue?

I think that one of the advantages of monetary policy, particularly through open market operations, is that, without very dramatic moves, you can step in and try it out, pulling back if you seem to be getting some perverse results. You can feel your way along before the movement you are working with has come to a critical point.

COMMISSIONER GIBSON: In your experience, it confirms your belief that these moderate movements this way are fairly effective?

MR. SPROUL: Yes, I think they are fairly effective. I would not want that to be understood as meaning, I think we were always right and got

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MR. SPROUL: Yes. I think they are fairly effective. I would not want that to be understood as meaning, I think we were always right and got

the right results, because we did not.

The criticism used to be, in some of our critical days, "You cannot get anywhere changing the hat size" -- by moving rates around by one-eighths. I do not think you can get the desired effects if monetary action is so moderate as to be ineffective, or so drastic as to be intolerable. There is a middle ground between the intolerable and the ineffective which is available to the monetary authorities, however, and which can be used to advantage as part of a general economic programme.

THE CHAIRMAN: When a moderate step is taken, such as you have described, that might have, to some extent, a psychological effect on the market?

MR. SPROUL: Yes, I think it might.

THE CHAIRMAN: To what extent would that be taken as a signal?

MR. SPROUL: If it were done through open market operations it could be a very mild signal which, perhaps, would not be observed except by those looking closely, or it could be something more. If it were done by way of the discount rate, and if the monetary authority has been following the practice of not changing the discount rate frequently, it could be a signal of more significance more readily discernable by the casual observer of economic affairs.

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There may also be at times what has been called an open mouth operation to indicate or hint to the market what your intentions are. It is a question of whether you feel a definite, positive and clear action is needed, or whether you are just mildly tugging on the reins. Someone once said that monetary policy has become a gentle tugging on the reins administered by the horse, but I do not agree with that.

COMMISSIONER MACKINTOSH: I do not know anything about the markets, Mr. Sproul, and I wonder if you have any historical or hypothetical examples with which to illustrate the sentiment that you have expressed on page 4 of your memorandum where you speak of the flexibility of monetary policy and say it can probe and withdraw, apply pressure or relax pressure in varying degrees, and test the substance of an economic movement or a structure of interest rates without final commitment. "Without final commitment" is easily understood, but, if you have some particular objective, what is the reality behind those words? Can you describe that for a layman?

MR. SPROUL: Well, it involves the close and continuous attention of the monetary authority or the central bank to the situation in the money market. I could perhaps describe it best by referring to open market operations which I now consider to be the heart of central bank or monetary policy. In that respect in our own operations at the Federal Reserve Bank of New York, at the so-called trading desk, our people

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were in constant touch with the government security dealers who themselves are the first point of contact with the money market. They were also watching various rates in the market, such as rate on Federal funds, (the rate on borrowing of excess reserves that are available in the whole banking system to supplement the reserves of an individual bank), also the rate on bank loans to government security dealers, which is a very sensitive rate, and then moving out through the whole rate structure and sensing whether ease or tightness is developing in the money market.

Their immediate purpose in this exercise was to smooth out ordinary day-to-day, or week-to-week, variations without necessarily changing the direction or intensity of policy, but if a change of policy has been decided upon they would begin moving in that direction continuing at the same time, to watch the effect of their operations on this sensitive money market, trying not to proceed so far, either in terms of actual availability of reserves or in terms of the market's anticipations and expectations, as to bring about a rough and jagged change in the situation. They attempt,rather, to have the adjustment go forward smoothly.

I think that is what I would mean by this ability of monetary policy to probe, to enter in, to withdraw,to apply pressure gradually, and so on, watching at all times its effects on the money market, effects which ramify throughout the economy, not only

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geographically through various means of communication -- which are prompt and speedy -- but through the various financial intermediaries and through the business community which is in constant touch in one way or another with some elements of the money market.

COMMISSIONER MACKINTOSH: How would you test out the structure of interest rates?

MR. SPROUL: Let me take the example, as I understand it, of our situation in the beginning of 1961 when our economy was in recession although beginning to recover from the decline of 1959 and 1960. It would have been desirable then to have easy money, in general terms, and relatively low interest rates, but our international position was such that the extent of ease and the level of interest rates, which had been thought desirable in earlier periods of recession, would have been dangerous; when short term money rates pushed down to the levels they had reached in earlier post-war recessions would have exposed our balance of payments to disadvantages in terms of relative short-term interest rates in various world financial centres. So, an attempt was made to achieve a structure of interest rates which would not be so low as the ease of money might have suggested at the lower end, but which would respond as much as was possible to that ease of money out through the intermediate and longer area of the structure of rates.

Now, that was considered to be a difficult tight-rope walking performance, but I think it had some success. It was a combined action of monetary

through the various financial intermediaries and through the business community which is in constant touch in one way or another with some elements of the money market.

COMMISSIONER McKINNON: How would you tell out the structure of interest rates?

MR. SIMON: Let me take the example. So I understand it, of our situation at the beginning of 1961 when our economy was in recession although beginning to recover from the decline of 1959 and 1960. It would have been desirable then to have easy money, or general terms, and relatively low interest rates, but our international position was such that the extent of ease and the level of interest rates, which had been thought desirable in earlier periods of recession, would have been dangerous when short term money rates pushed down to the level they had reached in earlier post-war recessions would have exposed our balance of payments to disadvantage in terms of relative short-term interest rates in the world financial centres. So, an attempt was made to achieve a structure of interest rates which would not be as low as the ease of money might have suggested at the lower end, but which would respond as ...

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Now, that was considered to be a difficult tight-rope walking performance, but I think it has

policy and debt management. The monetary authorities did not make funds as easy as they had in previous recessions, but they kept them relatively easy longer. The treasury continued to do a large amount of financing through treasury bills. There were increased issues of treasury bills. The amount of government instruments in the short market was large. Short term rates were held at around $2\frac{1}{2}$ per cent for 90 day bills instead of being allowed to go down as they had in previous recessions to $1\frac{1}{2}$ per cent. Rates in the intermediate and longer term areas were held down, partly through the maintenance of a general policy of relative ease and partly through some minor operations in that area of the government security market.

There is no attempt however to establish a fixed structure of interest rates and say: "This is it." In that way we would get back to where we once were pegging government security prices in order to maintain a pattern of rates.

[illegible]

[illegible] not make funds as [illegible] as they had in previous recessions but they kept them relatively [illegible], the Treasury continued to do a large amount of financing through treasury bills. There were increased issues of treasury bills. The amount of government financing in in the short maturities was large. Short term rates were held at around 2½ per cent for 90 day bills instead of being allowed to go down as they had in previous recessions to ½ per cent. Rates in the intermediate and longer term areas were held down partly through the maintenance of a general policy of relative ease and partly through some market operations in that area of the government security market.

There is no attempt however to stabilize a fixed structure of interest rates and say: "This is it." In that way we would get back to where we were pegging government security prices in order to maintain a pattern of rates.

That was very difficult to get rid of after the war, and we would not want to get into the same position again. We coined the phrase "nudge rates", to describe what we are now doing which is to facilitate not oppose fundamental market movements. Our financial markets are not perfect. If there are sticky rates in the market, and if they are not moving in the right direction or as fast as they might move, you can, through open market operations, give them a nudge.

COMMISSIONER LEMAN: Mr. Sproul, I think you expressed a strong conviction in your memorandum to the effect that -- I am going back to objectives a little bit here -- price increase, or, at least, inordinate price increase, will tend in the long run to hurt your growth objectives in an economy. Am I right in thinking that that is a strong conviction that you hold?

MR. SPROUL: Yes, it is.

COMMISSIONER LEMAN: Some people have tended to argue about this point, have they not?

MR. SPROUL: Yes.

COMMISSIONER LEMAN: What is your feeling about those who use a statistical approach and say: "Well, look, those economies that have not worred too much about price increases have shown a better growth than those who have"?

MR. SPROUL: They may not have shown

a constant concern about price increases and may temporarily have gotten a more rapid rate of growth than some other countries, but eventually they come to a point where they have to show concern about price and wage and cost increases. Such comparisons recently have been mostly between Western Europe, and the United States and Canada. It has been said that the countries of Western Europe have been moving ahead at a more rapid pace than we have, and that there is something wrong with our system, or our setup, if we do not achieve the same rate of growth.

I think right now the countries of Western Europe, and Western Germany in particular as a prime example, have reached the point where they are running into the problem of increasing prices, increasing costs and increasing wages, and are having to take account of some of the things we have had to take account of in the past.

There is also the example of the French economy. They went ahead with a high level of investment more or less regardless of its inflationary effects; a high level of investment beyond the rate of current savings. France had two advantages, perhaps, over us in that it was getting large amounts of help from the outside while it was doing all this, and because it finally washed out some of the results by a substantial devaluation of its currency. That is another method of achieving a high rate of growth and then correcting the results you have

[illegible] worry about price increases and [illegible] gotten a more rapid rate of growth than some [illegible] countries [illegible] eventually they come to a point where they [illegible] to the concern about price and wage [illegible] increases. Such comparisons recently [illegible] been mostly between Western Europe, and the United States and Canada. It has been said that the countries of Western Europe have been moving ahead at a more rapid pace than we have, and that there is something wrong with our system or our setup if we do not achieve the same rate of growth.

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gotten in the way of inflationary pressures, although it may be quite inequitable with respect to various sectors of the economy.

I think countries that have achieved high rates of growth and which work on somewhat the same economic systems as we do, cannot go along indefinitely without concern for rising prices and inflationary pressures.

COMMISSIONER LEMAN: Do you believe, sir, that the reason for this is that some elements in an economy cannot learn to adjust themselves to the price curve; is that the reason why it would hurt growth?

MR. SPROUL: No, I think the reason is that inflation introduces an over-emphasis on the element of speculation in the economy in terms of both plant capacity and inventory, which leads to a critical situation -- an over-anticipation of the possibility of producing and marketing goods at a rising profit. When effective demand no longer equals supply, the cut-back is more serious than would have been necessary, or that would have been found necessary in more modest cyclical movements. Inflationary pressures exaggerate the upswing, which in turn exaggerates the down-swing in those cyclical movements which, I think, are inevitable in our type of economy.

COMMISSIONER LEMAN: I didn't define my terms in asking the question. I am thinking of these theories which said that you might do better if you set yourself as a valid objective, instead of price stability in the absolute or the long run, to just think of a trend of, say, 2 per cent for a year; something orderly of that type. There have been such theories expounded.

MR. SPROUL: We had a very aggressive proponent of that theory, Professor Schlichter of Harvard, who expounded it in and out of season.

I think the idea of a gradual slow creeping upward movement in price is a nice idea, but it is one that is liable to get out of hand. I think there are forces in our economy which are always moving in that direction. I am thinking of the inflexibility downward of price in our economy and the inflexibility downward of wages in our economy, the lack of mobility in the labour force which leads to continuance of operations and of labour in areas where the demand has subsided. This creeping inflationary pressure is likely to gain momentum over time, and even if it doesn't, a gradual rate of change in prices of say 2 per cent a year becomes, over ten or twenty years, a very substantial change in the price level. In economies where capital assets and financial assets are measured in terms of their value over long periods of time, you can't welcome such substantial change, even though the annual increase in

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MR. STROUD: We had a very aggressive proponent of that theory, Professor Schlichter of Harvard, who expounded it in and out of season.

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price is apparently only a modest one.

You can have savings, for instance, losing a substantial amount of their purchasing power over a period of ten or twenty years with a very small annual increase in the price level. I think it comes down to the fact that, with the best of intentions and with the most skilful of operations, you may have some gradual increase of aggregate prices in our kind of economy, but to accept some figure as the one you should aim at from year to year, would be dangerous and undesirable.

COMMISSIONER LEMAN: Well, in referring to this in your statement you use the expression "aggregate prices", and I believe it was last week that Professor Bernstein was talking to us and he was referring to the prices of industrial goods as being the thing to aim at. I assume in the context in which he was speaking that he was concerned more with international relationships, but he admitted there was such a bias towards a gradual increase of consumer prices in the domestic market anywhere and that he seemed to imply that that was unavoidable; they had to go up gradually.

MR. SPROUL: I think it may be unavoidable, but I don't think we should acquiesce and enjoy it. I think we should exert some influence to prevent its getting out of hand. That is one of the problems and this would apply to the business community as well as the whole economic body. There is a question whether the business community will go forward and take the risks and make the ventures which are necessary and desirable

to have an expanding and growing economy without some of the stimulation of rising prices. They had it for a number of years after the war and now it has subsided, it is not there, and we still don't know whether business is going to go ahead and make the ventures and take the risks which are necessary to keep us in motion in an economy which doesn't have an inflationary bias.

I think it is and, I think as we have said, that there are these pressures on the side of increasing prices, particularly for consumer goods and within the domestic economy, disregarding raw materials prices for the moment. It is desirable that these pressures be watched and that we not submit to them as being either inevitable or desirable and something that we should accept without attempting to restrain their growth.

COMMISSIONER BROWN: Sir, would you care to express an opinion on the effect of savings in the personal sector of these continually increasing price levels?

MR. SPROUL: Well, I think that there you have one of the disadvantages of even a gradual increase in prices, a creeping rise in prices. The purchasing power of savings, over time, is gradually eroded by that sort of development.

Now, there may be offsets on the other side; the saver is also an income earner, and depending on where he fits into the economy and whether his wages are

to have an expanding and growing economy without [illegible]

of the stimulation of rising prices. They had it

for a number of years after the war and now it has

subsided, it is not there, and we still don't know

whether business is going to go ahead and make new

ventures and take the risks which are necessary to

keep us in motion in an economy which doesn't have

an inflationary bias.

I think it is so, I think as we have seen,

that there are these pressures on the side of

[illegible]

and within the domestic economy, disregarding the

desirable prices for the consumer. It is desirable

that these pressures be relaxed and that we not regard

them as being either inevitable or desirable and

something that we should accept without attempting

to restrain their growth.

COMMISSIONER [illegible]: But, would you care

to express an opinion on the effect of [illegible] on the

general sector of these continually increasing price

levels?

MR. [illegible]: Well, I think that there you

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increase in prices, a creeping rise in prices. The

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Now, there may be offsets on the other

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so where he finds the savings [illegible]

going up with prices or faster than prices or slower than prices, determines whether there is an offset or not. But taking savings by themselves there is damage to the savings habit in a gradual or creeping inflation, or whatever you want to call it.

THE CHAIRMAN: Can you recall a period in history in modern times where there was stability of prices over an appreciable length of time? We hear so much discussion about stability of prices and I am just wondering when we really have had it; is there any time we can look back to as an ideal in that respect?

MR. SPROUL: Well, I am not very good on recollection of the performance of statistical measures in historical time , but I think in our country we had a period of relatively stable prices, stable commodity prices in the decade of the twenties for a considerable period.

THE CHAIRMAN: Commodity prices; you mean the wholesale price?

MR. SPROUL: I mean general commodity prices at wholesale and retail. I was trying to avoid stock prices. That within my memory is a period when we had stable prices for a few years.

THE CHAIRMAN: Well, which decade was that, the twenties?

MR. SPROUL: Yes, in the decade of the twenties.

THE CHAIRMAN: From 1920 to 1930?

MR. SPROUL: From 1921 to 1929, along

there.

THE CHAIRMAN: Well, 1921 to 1929 is not a very long period.

MR. SPROUL: No. Since then, of course, we have had the great depression and our danger then was falling prices and deflation. We have had the war period and the post-war period and we have now within the last two or three years, in our experience -- which again is a very short period -- come into an area of relatively stable prices in the aggregate. As I say, my recollection is not strong, but I think you probably would find perhaps in the 1880's or the early nineteen hundreds periods when there was some stability of prices. The intervention of wars has been a great force which has knocked out whatever tendency to stability of prices which had existed in our economy. The great inflationary periods have been the periods during and following the wars and we have had wars frequently enough, regrettably, to have a recurrence of inflationary periods in our economies which has obliterated the possibility of any long period of stable prices.

THE CHAIRMAN: What I had in mind was are we trying to accomplish something which never, in fact, has been accomplished, and this is a new venture, perhaps? It may be that it is possible to do it, but ---

MR. SPROUL: I don't think ---

THE CHAIRMAN: I don't want to be too dogmatic about it at the moment.

MR. SPROUL: It could be a hopeless venture, but I don't think it is a new venture. It is something we have sought at times in the past and, as I have indicated, I think it is something we should still seek to achieve. In part this goes back to the question of others having seemed to achieve higher rates of growth than we have, without putting so much emphasis on the stability of aggregate prices. I think stability of aggregate prices is one of the keys to sustainable economic growth, and by that I mean economic growth which doesn't have the violent ups and downs of major booms and severe depressions, which satisfies itself and its dynamic needs by more modest booms and by minor recessions in working out its way along the economic curve.

COMMISSIONER GIBSON: Would you say your views are based in part and on considerations of equity and on the kind of society which you believe desirable, rather than just the purpose of pursuing a price policy that fits the needs of growth?

What puzzles me is that while I personally agree with the sort of thing you say, let us look at a country like Brazil which has had considerable price increases and also has had a very good rate of growth. But maybe there are other things in there as well -- and this is true of a number of Latin American countries in the post-war period -- there may be other things in there which we don't want?

MR. SPROUL: Yes, equity, social situations in a country such as Brazil which continues on a course

. [illegible]. It [illegible] be a [illegible] venture,

but I don't think it is a new venture. It is something

we have [illegible] ught at times in the past and,

as I have indicated, [illegible] think it is something we shall

still seek to achieve. In ear[illegible]

this goes [illegible] back to the question of [illegible] why [illegible]
that we need
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down [illegible] of major booms and severe depressions, which

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way along the economic curve

[illegible] would you say your

views are based in part and on considerations of [illegible]

[illegible] the kind of society which you believe [illegible]

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at a country like Brazil which has [illegible] had [illegible]

price increases and [illegible] had a very good rate

of growth. [illegible]

as well -- and that is true of a number of [illegible]

[illegible]

by the other things in terms which we [illegible]

MR. [illegible]: Yes, [illegible]

[illegible]

of rapid inflation and periodic de facto devaluations; you have one group of a community which makes large profits on speculative ventures, on ventures which don't contribute much to the productive capacity of the country or, if they do, also result in their transferring part of the capital abroad as their profits accrue, and another part of the community continuing to live in a state of poverty, worsened by the inflationary price rises which are continually occurring. I think you get, in countries such as Brazil and some of the other Latin American countries, those violent differences in the rewards that come to different groups in the economy, which are not only contrary to the requirements, I would say, of sustainable economic growth, but are also contrary to the social and political soundness and stability of the whole community.

THE CHAIRMAN: We were told that in Sweden there has been a steady inflation since the second world war of about 4 per cent a year. I am not suggesting that the conditions in Sweden are similar to our country or your country, and the problems may be entirely different, but apparently from what we were told they wouldn't seem to be too much disturbed about that. They have a slower rate of growth, I understand, but nevertheless they did submit to that inflation and, of course, the wages did keep pace with the inflation.

MR. SPROUL: They have had a slower rate of growth than the other countries of western Europe and

[illegible] portions of the [illegible]

have one group of [illegible] [illegible] [illegible] large

[illegible] or speculative [illegible], or [illegible]

[illegible] contribute [illegible] to the [illegible]. Specific [illegible]

[illegible] or [illegible] their

[illegible] part of the [illegible]

source, and another part of the community [illegible]

[illegible] of poverty, [illegible]

[illegible]

[illegible] I [illegible]

[illegible] and some of the other [illegible]

[illegible]

[illegible] different groups [illegible]

which are [illegible] contrary to the [illegible]

[illegible] of [illegible], [illegible]

also contrary to the social and political [illegible]

and [illegible] of the whole community.

[illegible]

[illegible] the [illegible]

[illegible] of [illegible] years. [illegible]

suggesting that [illegible]

[illegible] country [illegible], [illegible]

[illegible]

[illegible]

[illegible] they [illegible]

[illegible]

[illegible]

[illegible] the [illegible]

Mr. [illegible]

they have a government and an economy which is much more controlled and planned than ours.

I don't think it has had extravagantly happy results in Sweden. They are satisfied with what they have and proud of what they have done, but I don't think they have shown a high rate of growth nor a high competitive ability in the whole world economy. However, I don't know too much about the Swedish economy, and the delights of the Swedish type of socialism, so you will not place too much reliance on what I have said.

THE CHAIRMAN: I think perhaps we are in the same position.

COMMISSIONER GIBSON: I would like to ask you a question, Mr. Sproul, about your views on wages policy. On pages 5 and 6 you make some comments about wages and the question of price determination, and I am not quite clear as to what your thinking is and I would very much appreciate it if you would elaborate.

You say at the bottom of page 6, for example:

> "The fundamental solution is being sought and, I think, must be sought in the collective bargaining area which now sets the scene for so much that happens to costs and prices. General monetary policy, by itself, cannot effectively reach through to this area without bringing about such variations in prices and production and employment

"as are no longer socially or politically tolerable nor economically desirable."

But you say on page 5 at the bottom of the first full paragraph:

"It may well be that, with less liquidity in the economy and a less insistent demand for everything, and with a labour movement which is gradually, if slowly, coming to some sense of responsibility for its economic environment, high level production and employment and stability of aggregate prices can find common ground."

Now, I don't say there is a conflict there, but I wonder if you would elaborate a little more on this question of wages policy. Do we need a wages policy or will one develop in the institutions as we have them now?

MR. SPROUL: I would hope that one would develop in the institutions as we have them now; I know our government -- and I observe that the government of the United Kingdom -- is grappling with this problem, whether there will be that sort of a development in the institutions as we have them now or whether there needs to be some further growth of government intervention in the wage bargaining area to assert what is called a national interest or a public interest in costs, and through costs in prices.

I was expressing a hope in one case, and an alternative striving for new hope, that existing institutions would bring about,

as far as I [illegible]

[illegible] dealing.

But you say on page [illegible], at the bottom of the first full paragraph:

"It may well be said, with less [illegible], in the present [illegible] is [illegible] for everything, and with a [illegible] which is gradually, if at all, coming to some sense of responsibility for [illegible] economic environment, a high level of [illegible] employment and stability of aggregate prices [illegible] good."

Now, I don't say there is a conflict there, but I wonder if you would elaborate a little more on the question of wage policy. Do we need a wage policy or will one develop in the institutions we have [illegible]?

A. [illegible]. I would hope that one would develop in the institutions that we have already. I [illegible] our government -- and I believe that the government of the United Kingdom -- [illegible]

[illegible] the institutions [illegible]

[illegible] there [illegible] to be [illegible]

[illegible] in the [illegible]

[illegible] called a [illegible]

[illegible]

[illegible]

[illegible]

an evolutionary solution of this problem.

It is perhaps because of having been conditioned by participation in the formation of monetary policy, and having been exposed to the frustrations of developments in the wage-price sector of the economy, which first opposed what you were trying to accomplish by monetary policy and then forced monetary policy to validate what had happened, in terms of an increased money value of production and employment which a rise in costs and prices had brought about, that I am lead to stress this point and to hope that the existing institutional structures are moving in the direction of bringing a realization of the necessity -- not an acquiescence -- of trying to keep the advance in wages and costs in proper relation to increases in productivity in the economy; of the necessity of dividing up the rewards on an increase of productivity more equitably among the wage earner, the management, the stockholder and the consuming public, the groups which are involved.

In my opinion, during the immediate post-war period -- the decade after the war -- the power and the aggressiveness of organized labour did grasp for organized labour a larger share of whatever increased productivity was developing in the economy than, over time, would be consistent with an equitable distribution of the rewards of increased productivity, either in terms of lower prices or better quality to the consumer or sufficient profits for the

owners and management to stimulate growth of investment and of production. I also think that this force not only was effective in its own area, but it permeated the whole economic structure, working out into the service industries, which are now a large part of our economy, and where there was little perceivable increase in productivity. The demands of relative compensation and of increased living costs did force increases in wages and costs which had developed in the industrial area, in the area of large-scale collective bargaining, throughout the whole economy, and gave us a bias, a strong general bias in that direction.

COMMISSIONER GIBSON: Do you think the prospects of this bias continuing are as much as they were, or do you think we are more likely to have a better balance in the next decade?

MR. SPROUL: I see, hopefully, signs of a better balance growing out of more mature leadership on the three sides, and growing out of the passage of the wartime and post-war demands on the economy which made it easy to increase costs and pass on the increased costs in increased prices. With a productive capacity which has been built up within some reasonable range of effective demand this will no longer be so easy. Looking at it from our point of view, also, with increasing competition from Western Europe not only in their markets but in our own market, the pressure of economic fact will help to bring about a better distribution of the rewards of increased productivity than we had in the ten years immediately following the war.

When it is no longer possible to meet demands for increased wages and fringe benefits, which are the major part of increased costs, by passing on increased costs in the form of increased prices, there will be a better climate for reaching what I would consider to be the more supportable or sustainable solutions. If government can do anything to promote that development, to participate in that development without becoming or trying to become the decisive arbiter of what the solutions are to be, I think we shall make

some progress.

COMMISSIONER GIBSON: You do not think there should be some national or government effort to say what reasonable wage increases are?

MR. SPROUL: No, I think if government gets too far into this sort of thing then collective bargaining ceases. It becomes a political matter of who can exert the greatest influence on the government to set the terms rather than a matter of collective bargaining between the private bodies which are supposed to be fixing the terms of agreements.

COMMISSIONER GIBSON: I suppose if you have a wages policy you have to have a profits policy as well?

MR. SPROUL: Well, you begin to have -- yes, a profits policy and a price policy. You are on the way to a system of more complete and rigid controls. I think we want -- and I suspect you would want also -- something that would be consistent with our kind of economy and our kind of political organization.

COMMISSIONER BROWN: Mr. Sproul, do you foresee a necessity to accept, at least on a temporary basis, a higher percentage of unemployment in the working out of this better wage level relationship?

MR. SPROUL; No, I do not. I would think and hope that we can work towards lower levels of unemployment than we have/had in the recent past -- certainly in our country. With respect to

unemployment we got up towards 7 per cent of the calculated labour force, and now we are down to between 5 per cent and 6 per cent. I hope that our recovery will continue, and that we can work towards reducing that unemployment. This hope involves the whole conception of sustainable economic growth as distinct from growth which is more rapid at one time but which is subject to more violent reactions. That whole concept is also one of trying to have sustainable employment, and unemployment at a reasonably low level allowing for the frictional unemployment, the between-jobs unemployment, and the incapacity or disability type of unemployment, about which there can be argument, as to how much it is or should be.

We have some distinguished sutdents in that field who said, when they were economists, that 4 per cent is reasonable, but when they became politicians they said it ought to be much lower than that.

It is not a question of accepting increased unemployment in order to achieve some other economic objectives. It is an attempt to reach a level of operation and rate of growth which will bring about some reduction in the rate of unemployment.

COMMISSIONER BROWN: I did not know whether you said this as a partial corollary of the bargaining process.

MR. SPROUL: No, I think that would not be a corollary of the bargaining process, that we would

reemployment we got to Friedman's [illegible]
calculated labor force, [illegible]
between 3 per cent and 6 per cent. I [illegible]
our recovery will continue, and that we can [illegible]
towards reducing [illegible] unemployment. [illegible]
whole [illegible]
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unemployment, the between-job unemployment, and
the inferiority or [illegible] of unemployment,
[illegible]

[illegible]

We [illegible]

[illegible] they were [illegible]
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objectives. It is [illegible]
question [illegible]
some reduction in the rate of unemployment.

[illegible]
You said this [illegible]

[illegible]

[illegible]

have increased unemployment.

THE CHAIRMAN: We will adjourn for 10 minutes.

--- A short recess.

THE CHAIRMAN: We will now resume.

COMMISSIONER BROWN: Mr. Sproul, on page 7 you refer to selective credit controls and you deal with the stock market margins. I wonder if you would tell us a little bit about your experience with consumer credit controls and mortgage credit controls?

MR. SPROUL: In my opinion we had some degree of success with consumer credit control. I am referring now particularly to the period in 1955 when we had the authority and when there was a concerted movement to reduce the down payments and to lengthen the time of repayment in connection with consumer credit, particularly consumer credit for durable goods. In automobile credit for example, I think we anticipated the demands of future years in that particular period and stimulated an increase in production and sales which borrowed from succeeding years and was a destabilizing force in the economy. Our attempts to moderate this relaxation of down payments and of repayments terms did have a desirable effect in controlling expansion in the use of credit in that area.

It was never easy to demonstrate; there was not acceptance by the people who were being regulated; there was not the necessary degree of acceptance to make regulation work with the highest degree of satisfaction, and there was the possibility of loopholes and escapes which made it difficult, so that the lot of the policeman wasn't a happy one, but I think we had some success there.

THE CHAIRMAN: We will now recess.

CONGRESSMAN [illegible]: Mr. [illegible], on page 7 you refer to selective credit controls and you deal with the stock market margins. I wonder if you might deal just a little bit about your experience with consumer credit controls and mortgage credit controls?

MR. [illegible]: In my opinion, we had some degree of success with consumer credit restriction. I am referring now particularly to the period in 1950 that we had the authority, and then there was a concerted movement to reduce the down payments and to lengthen the time of payment in connection with consumer credit, particularly consumer credit for durable goods. In [illegible] credit [illegible] [illegible] demands of [illegible] in that particular period, [illegible] an increase of production and sales [illegible] deterred from succeeding which had not a desirable [illegible] in the economy. [illegible] relaxation of down payments and of [illegible] did have a desirable effect in [illegible] expansion in the use of credit at that time.

It was never easy to [illegible] was not accepted by the [illegible] who [illegible] complaint. [illegible] acceptance to [illegible] with [illegible] degree of satisfaction, [illegible] of loopholes [illegible] that the [illegible] I think we had [illegible] success [illegible]

We had a lesser degree of success in regulating mortgage credit because there we ran into opposing social objectives of government which had a high degree of interest in the promotion of home ownership and the provision of mortgage money, to various groups in the community in ways which made it easy to borrow. This ran contrary to what we were trying to do in the control of that particular sector, but even there I think we did have some moderating influence for a time. However, the difficulties of administration, and the lack of general acceptance of the idea of control of these areas not only made our effectiveness less than it otherwise might have been but ultimately resulted in the power to regulate being withdrawn and in the continued unwillingness to restore it either as an active power or as standby power which might be used if the circumstances arose which made it seem desirable.

My own view is it would be desirable to have these powers as standby powers which could be invoked in circumstances where the use of credit in particular areas is exerting a destabilizing force; areas which we are unable to reach effectively both in time and in amount through general measures of credit control.

COMMISSIONER BROWN: In practice, which specific forms of control proved the more effective in controlling consumer credit; what particular type of control was effective or was relatively effective?

MR. SPROUL: The type of control which we exercised was the ability to fix the down payment and to fix a limit on the term of the borrowing.

Instead of, say -- to use a figure -- having to put down 10 or 15 per cent, the borrower could be required to make a cash payment of 20 per cent and the term of borrowing, instead of being 36 months, could be made 30 months. That sort of control I think had a measure of effectiveness:

COMMISSIONER BROWN: The former of these two types was tried here and it seemed to be generally avoided by increasing prices and accepting an uneconomic figure for a trade-in.

MR. SPROUL: Yes, there is that possibility of evasion and that is one of the reasons why the lack of acceptance of the idea of control makes it difficult, but there was a sufficient observance of the rules in our case, I think, for it to have some effect, and it is my impression that the same thing has been true in the United Kingdom where they have invoked a similar sort of control for hire purchases.

COMMISSIONER BROWN: You mention that in your opinion consumer credit in this period got out of control.

Could you give us a suggested measurement as to what is a sensible level of consumer credit?

MR. SPROUL: I don't know that I can put it in terms of figures, but I think it could be said that it is when relaxation of credit terms seems to be bringing forth a concentration of activity in one area of the economy which is out of line with the general level of economic activity, and when consumer demand is being directed towards specific kinds of goods

by relaxation of credit terms rather than by the price and quality of the product and the aggressiveness of the sales effort. To take the specific example of the automobile industry, it had its biggest post-war year in 1955 and up to the present time it has never gotten back to that level of operation. I think that was due to the fact that in 1955 they relaxed credit terms, both in relation to down payments and to the period of repayment, beyond what they had been and exhausted a part of the future market by stimulating current sales in that way.

COMMISSIONER BROWN: But you can't suggest a relationship between the gross amount of consumer credit and the national income?

MR. SPROUL: No, I think consumer credit has been a desirable force in promoting mass production and mass distribution of goods.

I might say, however, that when the extension of consumer credit has made such inroads on the purchasing power of the community that, for a period, consumers are paying back on old loans a larger amount than, over time, had been the case. Production will be depressed, because the paying off of old debts will be taking a larger share of the income of the community than would have been taken if there had not been a rapid increase of consumer debt because of a relaxation of credit terms.

COMMISSIONER BROWN: Do I gather from that that if this increase takes place without a noticeable

relaxation of the controls by the grantors of such credit, you haven't got the same worries about it?

MR. SPROUL: No, if it doesn't involve an increasing use of credit on progressively easier terms I wouldn't have the same worries about it.

COMMISSIONER BROWN: Would you care to comment about these on the other side of the economy, such as a sense of stimulating the process when things are quiet?

MR. SPROUL: I think that control of consumer credit does permit of either stiffening the controls when restraint is desired or relaxing the controls when stimulation is desired. It is a flexible form of regulation which can be used to stimulate or to restrain.

COMMISSIONER MACKINTOSH: Could I interject a question there? I got the impression that in between critical periods the central banks' understanding of the consumer credit field, its acquaintanceship with it is largely statistical, and then you get into a period when it is thought they need to be restrained and come together. Do you see any hopeful possibility in your suggestion of standby power that the existence of these powers would lead both the central bank and the consumer credit industry to reach a further understanding as to the kind of operations that were desirable for the economy of some type other than the actual exercise of the standby?

MR. SPROUL: Yes, I do. I think if the monetary authorities have the power in standby form that they would be developing their knowledge of and their information concerning the effects of movements

in consumer credit. And I think the consumer credit industry, on its side, knowing that these powers are there and might be used, would be more interested in working with the monetary authorities to try to develop a better understanding and perhaps some better measures, better yardsticks, by which to judge the influence and the effect which consumer credit is having on the general economy. I think there would be a possibility there -- and a hopeful possibility -- of better performance on both sides if the standby authority was in existence.

COMMISSIONER MACKINTOSH: Thank you. I have some other questions, Mr. Sproul. On pages 9 and 10 you have a substantial paragraph, which I found to be admirable, on the relationships between fiscal and monetary policy and the relationships between their respective authorities, and you say that the independence of the central bank is now independence within the government, not independence of the government. Am I right in inferring from that paragraph that the achievement of understanding of a proper mix of policies, a common interpretation of what are thought to be the impending circumstances, that this should come primarily from frequent consultation and continuous contacts between these respective authorities, rather than from some more formal system of, say, directives?

MR. SPROUL: Yes, you are quite right in your understanding. That is what I was trying to suggest or advocate; a common course of action here is the sort of thing that can best be worked out by the recognition of a common

general policy, and by continuous consultation between those who have authority, in the fields of fiscal policy, debt management and monetary policy agreement as to what the common objective is, and as to how their various powers might be fitted together to try to achieve that common objective, can be achieved better in this way than by setting up either one director of the whole or a committee or a council having the power of decision with respect to authorities of the constituent groups. I think, certainly in our situation, the dangers of either an individual who had the sole directive authority or a council which had the sole directive authority, outweigh some of the possible frictions of the consultative method.

COMMISSIONER MACKINTOSH: A few days ago we had Professor Viner who took what I thought was -- at the time, at any rate -- a rather extreme view. He suggested the central bank ought to operate under a mandate from the government, which should be a written mandate and a public mandate, and would, until further notice, set the course of their monetary policy until a further mandate. He was speaking not of a broad statutory mandate but, as I understood it, something that would be from time to time in our case issued by the Minister of Finance, and under that the central bank would operate until they got another one. I gather that this would not be congenial to you?

MR. SPROUL: In our case, of course, I don't know who would give the mandate. The Federal Reserve system derives its powers from Congress, and I don't think a legislative body is in any position, in terms of

general public, [illegible]

[illegible]

with management [illegible]

what the [illegible]

[illegible]

MR. [illegible]

[illegible]

MR. [illegible]

[illegible]

administrative effectiveness to give periodic mandates as to what monetary policy should be.

The President and his advisors, and the Secretary of the Treasury -- who is the chief financial officer -- might be in a position to give mandates, but in our system they haven't the power as things are now to do that. But even if there was a different constitutional setup, I think it is much better to have the central bank able to press its views forcibly and continuously with respect to what monetary policy should be rather than having a mandate handed down saying that, for the present, your policy shall be so and so and such and such.

As I suggested in my memorandum if the views of the monetary authorities are wholly out of step with general governmental policy, you may have a situation where the responsible monetary authorities deem it necessary to resign rather than to acquiesce in a general governmental policy, but I think it is a matter which can ordinarily be worked out in consultation and in acceptance of general objectives, without reaching that sort of a critical situation.

COMMISSIONER MACKINTOSH: Would you think anything in the form of governmental directives ought to be, as it were, instruments of last resort or penultimate resort?

MR. SPROUL: Yes, I do.

COMMISSIONER MACKINTOSH: Rather than continuing process?

administration [illegible] consultation [illegible] committees as to what

monetary policy should [illegible]

The President and his advisers, and the

Secretary of the Treasury [illegible] is the [illegible]

officer -- might be in a position to give guidance

but in our system they [illegible] the power as [illegible]

now to do that. [illegible] constitutional [illegible]

constitutional [illegible]

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should be [illegible]

saying that, [illegible]

your policy shall [illegible]

As I [illegible]

[illegible]

general government [illegible]

situation [illegible] responsible [illegible]

deem it necessary [illegible]

to acquiesce [illegible]

I think it is [illegible]

as in consultation and [illegible]

lines, without [illegible]

[illegible]

[illegible]

[illegible]

ought to be, [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

MR. SPROUL: Yes.

COMMISSIONER MACKINTOSH: Thank you, that is all I have on that.

COMMISSIONER GIBSON: I would like to ask you another question on the same line. You tell us that the Treasury is pursuing a budgetary policy which, to the central bank, seems inappropriate. How far does the central bank carry on in the line it thinks it should and, indeed, how far does it work to offset the effect of this inappropriate treasury policy? This must happen quite frequently; just because of the slowness of changes in budgetary policy. When do you decide that there is a real conflict in policy here and not something that is appropriate for you to offset or partly offset?

MR. SPROUL: I don't think you can pick a point and say in advance that this is it; I think if there is a general economic policy of the government, that you would hope and expect that budgetary policy and monetary policy would both be directed towards making effective that general policy.

As you say, there may be lags in the effect of the application of budgetary policy which will run into the more flexible actions of monetary policy.

If the monetary policy is not designed and not put forward in opposition to the general governmental policy, but only as an offset to a temporary undesirable influence of budgetary developments within that general policy, I think you would have a basis for agreement between reasonable men who are

is all I have on that.

CHAIRMAN [illegible]: I would like to ask you another question on the same line. You tell us that the Treasury is pursuing a [illegible] policy wh[illegible] to the central bank seems inappropriate. How far does the central bank carry on in the line it thinks it should and, indeed, how far does it work to offset the effect of this inappropriate treasury policy? This must happen quite frequently just because of the slowness of changes in budgetary policy. When do you decide that there is a real conflict in policy [illegible] and not something that is appropriate for you to offset or partly offset?

MR. [illegible]: I don't think you can [illegible] a point and say [illegible] I think if there is a general economic policy [illegible] government, that you would have [illegible] budgetary policy and monetary policy [illegible] words making effective that general policy.

As you say, there may be lags in the [illegible] of the application of budgetary policy [illegible] into the more flexible [illegible] of monetary policy.

If the monetary policy is not [illegible] put forward [illegible] general policy, but only [illegible] undesirable influence of budgetary [illegible] general policy. I think [illegible] for agreement between [illegible]

operating under the same general policy, even though for the time being the budgetary and monetary policy may be offsetting one another to some extent.

COMMISSIONER MACKINTOSH: Suppose it isn't a lag and the government doesn't want to reduce its deficit and yet the central bank isn't told specifically what the policy is; you are getting into a pretty difficult area.

MR. SPROUL: Yes, an absolute conflict of opinion as to what the budgetary policy and debt management policy and monetary policy should be in terms of the overall general governmental policy; you get into a very difficult area and you may come to the point when the monetary authorities, looking at it from their side, have to say, "Well, we can't go on with this; we think it is wholly wrong and therefore we will have to turn over our powers to other hands."

COMMISSIONER MACKINTOSH: Suppose you are left with the job, which nobody objects to, of partly offsetting the effects of the continuous deficit, let us say, and you are not told that you are not to offset it, is this a tolerable position for the central bank to be in? This may be the mix that suits the political situation at the time.

MR. SPROUL: If the continuance of the budgetar

perating under the [illegible] policy, even [illegible] or the time being [illegible] may be offsetting [illegible] to some [illegible]

[illegible] a lag and the government [illegible] deficit and [illegible] the [illegible] what the policy [illegible] different area.

MR. SPELL [illegible] opinion as to [illegible] the [illegible] and that management policy and [illegible] policy [illegible] terms of the overall [illegible] policy [illegible] get into a very difficult [illegible] the point [illegible] the [illegible] it from their side [illegible] on with [illegible] will [illegible]

[illegible]

[illegible] the debt [illegible]

[illegible] the [illegible]

[illegible]

[illegible] the [illegible]

[illegible] be [illegible]

policy is in line with the generally agreed economic policy, then you could live with it for a time, but if it is a departure from the generally agreed overall economic policy, then I think you could not live with it and would have to try to make your views prevail in consultation and argument, or say that you cannot accept the responsibilities of participating in the program.

COMMISSIONER MACKINTOSH: You are being asked to carry too much?

MR. SPROUL: Yes, you are being asked to carry too much, and in an atmosphere which makes your efforts ineffective.

COMMISSIONER BROWN: How about a similar situation with respect to debt management, which is on a slightly more flexible basis than fiscal policy? On page 11 you say at the sentence at the top of the page:

"What is needed is a clear recognition of their joint and separate responsibilities by men who bear allegiance to the same general economic policy of government, and regular means of consultation and co-ordination of policies and programmes."

You are working in favour of separate authorities coming together at some stage. I wonder if you could give us your picture of just where you think they should come together, at what stage do their responsibilities actually merge?

MR. SPROUL: Well, let me try to give you two examples from our experience.

In the late 1940's and early 1950's we in the Federal Reserve System got

[illegible] is in line with the generally agreed economic policy, then you would have to [illegible] a fine, but if it is a departure from the general [illegible] agreed [illegible] economic policy, then I think you would not [illegible] and would have to [illegible] to be a party to the [illegible] in consultation and agreement, or [illegible] say what you [illegible] accept the responsibilities of being a [illegible] party.

COMMISSIONER [illegible]. You are being asked [illegible]

MR. [illegible]. [illegible] you are being asked to carry too much, and in accordance with a [illegible] efforts ineffective

[illegible]. You have a rather situation with respect to [illegible], which is a slightly more flexible one than [illegible] policy [illegible]

"That is [illegible] is a [illegible] of each [illegible] and separate requires [illegible] by [illegible] or [illegible] the same general economic [illegible] have [illegible] are together [illegible] [illegible] coordination of [illegible] in the [illegible] of [illegible] in their [illegible] are appropriate."

You are working in favor of [illegible] at some [illegible] I wonder if [illegible] have your picture of [illegible] [illegible] [illegible] to [illegible]

[illegible]

into an argument with the Treasury about the support of government security prices, about maintaining a pattern of interest rates in the government security market, and we said that we no longer could maintain an effective and sound monetary policy if we had to continue to support a pattern of interest rates in the government security market by pegging government security prices out through the whole range of maturities. That argument came to the point where we couldn't reach agreement until it became clear, after consultation with the executive and with the legislative branch of the government, that our side of the controversy had more support than the Treasury side, and that if it came to a showdown within the government our position would be the prevailing one. Then we were able to reach what was called an accord, which provided certain bridges over which the Treasury people could retreat and which relieved us of the responsibility of pegging prices which we had assumed, previously, in consultation with the Treasury, as part of our joint responsibility.

Now, that was a case where we did come to one of these conflicts of view and authority and where, in our situation, without any definite directive by anyone, it became clear that the final decision would be in our favor. Fortunately this incident gave impetus to the development of methods of co-ordination and consultation which has continued right up to the present time; more frequent meetings between those in charge of debt management and monetary policy, and by "frequent meetings" I mean at least once a week to discuss their mutual

problems. / There has developed a greater understanding of the responsibilities and the methods of operation of both monetary policy and fiscal policy as represented by the Federal Reserve System and the Treasury Department. There has been so much cross-fertilization that in recent periods, when it was most desirable that debt management policy and monetary policy be working in double harness, the Treasury Department and the Federal Reserve System have found that they could work within a general economic policy without any final directive or any single authority telling each of them what they had to do.

People in the Treasury Department now know more about what the Federal Reserve System is doing, and I think the people in the Federal Reserve System now know more about the problems of debt management, and what the Treasury is doing. In the past several years there has been a much greater accommodation of interests and reconciliation of views than had been possible before.

COMMISSIONER GIBSON: I have a question, Mr. Sproul, about your views on open market operations. I take it from your memo in a number of places that you don't believe that the Federal Reserve should be bound by any specific policy on bills only or bills preferable; you imply in several places that it is appropriate that they should have a very free hand. If this is correct, would you say a word or two about the quite widely expressed fear that operations in medium and long-term areas in the market are disturbing to the functioning of the market.

MR. SPROUL: My personal opinion is that that argument has been stressed and over-stressed by those who are advocates of bills only or bills usually, that they use it as one of the arguments to try to make their view prevail.

Whether the monetary authority operates in only one sector of the market and deals with money or "bills only" or "bills usually," or whether it operates out through the whole range of maturities of Government paper from time to time, you haven't a completely free market. You have a market which is, at all times, watching what the monetary authority is doing, both in its immediate effect and in anticipation of what it is going to do in the future and what the effect of that will be. You have a market which is conditioned by the operations of the monetary authority, and I don't think it is any more disturbing to the market to have the monetary authority operating, at times, in the intermediate and long term areas of the market than in the short market. I don't think it is any more disturbing or creates any more interference with the functioning of the market than having the monetary authority operate wholly in the short end of the market, expecting the market by arbitrage to spread that influence out through the whole range of maturities. Whether or not the monetary authority operates out through the whole range of maturities, what it does is going to have an influence out through the whole range of maturities, and upon the structure of interest rates. I think this claim that operations in other

than the short term area interferes with the proper functioning of the market was partly an attempt to make a case for "bills only" or "bills usually." Also, I suppose, it had in it some reflection of the previous period when we were pegging prices of government securities, and the fear that there would be attempts to return to that practice so that the market would be in the hands of people who had their fingers on the levers and would be a little itchy, maybe, to exert a little more control of prices than they ought to have. There was real fear, I suppose, that we would gradually slip back into trying to establish a fixed pattern of rates, rather than attempting to nudge the market in places where it was sticky.

To repeat, I don't agree with the idea that open market operations beyond the short area of the market are so different that they are disturbing in a substantial or in a damaging way to the proper functioning of a money market and a capital market.

COMMISSIONER GIBSON: Isn't one of the fears in this that if the central bank takes an important position in the longer end, and it turns out to be wrong, it has then got a very difficult position to unscramble, which may affect its ability to pursue an effective monetary policy?

MR. SPROUL: In the terms in which I have discussed open market operations, of course, I would hope and expect that the central bank would be probing the market and wouldn't get into a position in which it was so far away from the underlying tendencies in

[illegible] the short-term gov't [illegible] with the proper functioning of the market [illegible] and [illegible] make a case for [illegible] usually [illegible]. I suppose, it led to [illegible] period when we were [illegible] of government securities, and the fear that [illegible] to return to [illegible] the market be in the hands of [illegible] the levels and [illegible] a little more [illegible] they ought [illegible]. There was [illegible] slip back into [illegible] rates, rather than [illegible] in places where it [illegible].

I [illegible] agree with the [illegible] open market [illegible] market are so [illegible] substantial [illegible] of the functioning of a more [illegible].

COMMISSIONER [illegible]: [illegible] to this that it [illegible] an important position in the [illegible]

[illegible]

[illegible]

[illegible] discussed open market [illegible] rate and extent [illegible] [illegible] was of the [illegible]

the market -- the relationship between the supply of funds and the demand -- that it would be out on a limb and couldn't get back. I don't think you can make policy on the basis that you are going to be so badly wrong that your policy will be destructive; otherwise you would never make any policy.

COMMISSIONER GIBSON: Do you say you would be much more careful and have to have more reason for carrying out operations on the long end than on the treasury bill end?

MR. SPROUL: Yes, I think you can say that, in ordinary circumstances, when you are merely adjusting the day-to-day and week-to-week and seasonal fluctuations in the reserve position of being such a dominant factor that you were really the controlling influence with respect to rates and prices in other areas of the market

COMMISSIONER GIBSON: In other words, if you could see a real advantage from the standpoint of public policy, and felt reasonably confident about it, you would feel it was all right to go into the longer end?

MR. SPROUL: Yes.

COMMISSIONER GIBSON: Otherwise you would not be so inclined?

MR. SPROUL: No. Just on a hunch I would not, without some good reason, think, "Well, we will now go into the long market and try to establish a different level of interest rates from that which has been developed by the market itself."

COMMISSIONER BROWN: When you are operating in this way, which is an operation through the whole spectrum, though it is a light touch on the long end, you are in fact, are you not, influencing the debt structure that is held in the public sector?

MR. SPROUL: Yes.

COMMISSIONER BROWN: To what extent do you think the changes in this debt structure affect spending in the public sector, or do you think it has any? When I said, "spending in the public sector," I was perhaps confusing things a little here. I meant, spending by the public.

MR. SPROUL: There, I think, perhaps the point of clarity is, if the situation is one in which you want to stimulate spending in the public sector, then debt management, which involves financing with instruments which will go into the banking system

and lead to an expansion in the supply of money and credit, would give you that stimulus to spending by the public.

On the other hand, if you are in a period of exercising some restraint, or trying to, on public spending, you would hope that debt management could be so arranged that public savings would be tapped by the kind of securities offered and the prices and yields at which they were offered, so that public spending would be reduced and some public income would be drawn off into savings through investment in the longer term government securities.

COMMISSIONER GIBSON: How far do you think the central bank has a responsibility for maintaining an orderly security market?

MR. SPROUL: I think it has a responsibility there, but I think that ordinarily a properly functioning market will itself maintain order, and that it is only in unusual and infrequent circumstances that there will be what have been labelled, "wind pockets," that is large differences in prices between purchases and sales, so that the market tends either to become panicky, on the down-side, or extravagent, on the up-side. Then the monetary authority would be justified in stepping in to maintain orderly markets.

There has been some semantic juggling there. Either you try to maintain orderly markets, or prevent disorderly markets. My own preference is to prevent disorderly markets. letting the

market itself maintain order in the ordinary and usual circumstances, which I think it will.

COMMISSIONER GIBSON: When you talk about, let us say, preventing disorderly markets, how do you define it? Do you look at a given yield curve at a particular time and say, "This more or less makes sense in our thinking"?

MR. SPROUL: I would say, where there is such pressure of selling in the market, more specifically in government securities, that the dealers who make the market are dropping their prices substantially between transactions, so that the selling pressure begins to accumulate and prices decline rapidly without stimulating buying interest, then you have a disorderly market.

It is through constant touch with the market, and observing what is going on in the market, that you sense or feel that the increasing pressure of sales and declining prices are not bringing out a response on the buying side, which would take care of the situation before it became cumulative and disorderly.

COMMISSIONER GIBSON: This is a day-to-day and almost hour-to-hour type of thing?

MR. SPROUL: Yes, it is. I think the necessity only arises infrequently, but you watch it from day-to-day and hour-to-hour and you are constantly in touch with the market. You do not just set up a yield curve and look at it in your office without keeping in touch with the market. You keep in touch with your market.

market itself maintain order in the ordinary [illegible] circumstances, which I think it will.

COMMISSIONER [illegible]: When you [illegible], let us say, [illegible] market, how do you define it? Do you look at a given yield curve at a particular [illegible], [illegible] sense in our talking?

MR. SIMMONS: I would say where there is such pressure of [illegible] the market, [illegible] in government securities, that the dealers [illegible] the market are [illegible] between transactions, [illegible] begins to accumulate [illegible] dealers [illegible] stimulating buying interest, [illegible] a disorderly market.

It is [illegible] and observing what is going on in the market, [illegible] sense or feel that the market is [illegible] declining prices are [illegible] the buying side, which would take care of the situation before it [illegible]

COMMISSIONER [illegible]: [illegible] and almost instantaneous type of thing?

MR. [illegible]: [illegible] I think the necessity will arise [illegible], but you [illegible] it from day-to-day and [illegible] you are constantly in touch with the market. You [illegible] just set up a [illegible] office without [illegible] keep in touch [illegible]

COMMISSIONER GIBSON: How far do you use a yield curve appropriate to the relationship of the various rates, one with the other?

MR. SPROUL: In the ordinary course, since we quit having a yield curve on a prescribed pattern of rates, we do not use them very much, except to observe what variations the market itself is creating.

COMMISSIONER GIBSON: Say a yield table?

MR. SPROUL: I would say they are not used very much except as a mechanical aid. The yield curve is something you keep in mind, but not something that suggests the time to step in or the time to stay out of various areas of the market. You are working from the standpoint of other things than a yield table.

COMMISSIONER GIBSON: This would not be the major consideration in deciding to intervene in the longer end of the market?

MR. SPROUL: No, not unless a yield curve confirmed, by the jerkiness of its movement and wideness of its fluctuations, what you had gathered from your continuous contact with the market, namely that the situation was getting disorderly. On more general policy grounds you would have other considerations in mind.

COMMISSIONER GIBSON: What you are looking for -- at least, this is the context in which you have been talking -- there would be times when you would want to influence the shape of the yield curve for a specific monetary objective, is not that correct?

MR. SPROUL: Yes, without regard to maintaining an orderly market or correcting a disorderly market. There would be times when you felt your operations at the short end of the rate structure were not reflecting themselves out through the whole structure of rates, when there was stickiness here or there, and you would try to see if a little pressure would dislodge some of the stickiness.

The general theory would be that you are not trying to impose your will on fundamental developments in the market, movements in one direction or another, but that you are trying to eliminate stickiness or blocks in an imperfect market which are interfering with your major monetary policy objectives. If you find that you have misjudged the fundamental influences, and unless the market has become disorderly you withdraw from the nudging process.

COMMISSIONER BROWN: Do you find that the Street reacts very quickly when you give a nudge -- in the sense, if you indicate a buying interest in something, do you find this encourages the Street operators to build up an inventory, or does it encourage a stabilization through the market generally?

MR. SPROUL: I think "the Street" is also trying to determine whether you are going with the tide or trying to move against it. If they think you are

going with it, I think they will react very quickly in terms of building up an inventory and establishing a position. If they think you are going against it, they may draw back. What you do will have an immediate effect on their thinking and on their guessing, but they will also, as you are, be trying to determine whether you are trying to get rid of some stickiness or to go against the tide.

COMMISSIONER BROWN: Does this sometimes tend to make your job more difficult?

MR. SPROUL: It makes it more difficult, but only in degree. The fundamental difficulty is in determining which forces are in the ascendant and where you can best exercise your influence, or whether you should try to exercise any influence at all. The uncertainty of the reaction of the market is an added difficulty, but if you are in constant touch with the market and not just looking at quotations, if you know the people in the market and are talking with them and getting their views, you have some idea, as to what their reactions are or may be, and you get some help there.

COMMISSIONER BROWN: Do you find there is a tendency for them to react faster on the down-side than on the up -side?

MR. SPROUL: If you mean they are more apt to get hurt on the down-side than they are on the up-side, if they take a position, I would say, yes; they do not want to get hurt. They try to keep

acting with it, I think they will need very [illegible] in terms of building up an inventory and something [illegible] a possible. If they [illegible] you are going [illegible] they may [illegible] back. What you do will have an [illegible] effect on their [illegible] and [illegible] guesses, but they will [illegible] you [illegible] trying to [illegible] whether you are [illegible] against the [illegible].

[illegible] Then [illegible] tend to make your job more difficult?

MR. [illegible] It makes it more difficult, but only to [illegible] degree. The fundamental difficulty is in determining [illegible] and where you [illegible] exercise [illegible] whether you [illegible] all. The uncertainty [illegible] of the [illegible] is an added difficulty, but if you are [illegible]

[illegible]

just looking [illegible] market and [illegible] you have [illegible]

[illegible] that [illegible]

me, and you get [illegible] there.

[illegible]

is a tendency [illegible]

towards [illegible]

MR. [illegible] I [illegible]

to get [illegible]

[illegible], if [illegible]

[illegible]

their positions very light, if they think things are moving down.

COMMISSIONER BROWN: One small point in the practical application of the trading: does the Street know whether you are dealing for monetary policy or for government accounts?

MR. SPROUL: Not always. They try to find out in various ways but they do not always know, and I have a certain addiction to the value of uncertainty,at times,in exercising your influence in the market.

COMMISSIONER BROWN: You do not believe in clear and definite signals?

MR. SPROUL: Not always; sometimes, yes, and sometimes, no.

COMMISSIONER BROWN: To back up a little from this practical end of it, the Federal Reserve Bank in New York operates on the basis of directives. What sort of latitude is given to these directives? Are they of a fairly general nature, or fairly specific?

MR. SPROUL: The directives from the Federal Open Market Committee to the Federal Reserve Bank in New York are as specific as they can make them without interfering with execution, which is not very specific. But that is modified to some extent by the fact that in the endeavour to keep the channels of control as clear as possible, the Federal Reserve Bank of New York is in touch with the representatives of the Federal Open Market

their [illegible] very light, [illegible]

[illegible] moving down

[illegible]

the principal [illegible]

[illegible]

[illegible]

MR. [illegible]

[illegible]

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MR. [illegible]

[illegible]

from this [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

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[illegible]

[illegible]

[illegible]

[illegible]

Committee in Washington every day telling them what it is doing and why it is doing it, so that there is a constant exchange of information and views as to how the directive is being executed. That is a formal and regular practice. It is not something that just happens. Every day, after the market is opened and the figures of various factors which affect the supply of money and the supply of credit in the market have been assembled and worked out, and after it is decided how much buying or selling will be necessary just to offset the effects of float, or treasury disbursements or withdrawals, or gold inflow or gold outflow, and other factors which in the ordinary course affect the reserve position of the banks then it is determined whether the directive requires some positive move. That is discussed by the Federal Reserve Bank in New York with the people in Washington, and with people at other reserve banks whose representatives are members of the Federal Open Market Committee. The directive and the execution of it are kept in line in that way.

COMMISSIONER BROWN: Just a small point -- although it is not a very small point, just a practical point: the staffing of the trading desks of the department in New York, is this done from inside, or do you bring people in from outside, from the Street itself, on to the staff?

MR. SPROUL: We have brought people in from the outside when we have needed special skills or special knowledge, but most of the staffing is done within

mmittee in Washing[illegible] every day telling them wh[illegible] is doing and why, it is doing it, so that there [illegible] constant exchange of [illegible] and views [illegible] the directive is being executed. That is [illegible] and regular practice. [illegible] not something that [illegible] happens. Every day after the market is open [illegible] the figures of various [illegible] which affect the [illegible] of money and the [illegible] of credit [illegible] been assembled and [illegible] determined how much buying or selling will be necessary [illegible] offset the effects of [illegible], or treasury [illegible] on withdrawals, or gold [illegible] or other factors which in the ordinary course affect the reserve position of [illegible] that it is determined when the directive is [illegible] operation [illegible]. That is discussed by the [illegible] Reserve Bank in New York with the people in Washington, and with [illegible] of other Reserve banks [illegible] members of the Federal Open Market Committee. The directive and the execution of it are kept in line in that way.

[illegible]

Although it is not [illegible] point, [illegible] point: the [illegible] of the [illegible] the [illegible] do you [illegible] credit, up to the [illegible]

[illegible]

[illegible]

the Federal Reserve Bank, in New York itself. People from other parts of the system have come in as observers, but there has not been much recruitment from outside the Federal Reserve Bank of New York, either from other parts of the system or the market itself.

COMMISSIONER BROWN: The discussions that take place, aside from the actual trading itself, are these on all levels of the operation?

MR. SPROUL: Discussions with people in the market ?

COMMISSIONER BROWN: That is right.

MR. SPROUL: In the ordinary course, the minute-to-minute and hour-to-hour discussions by telephone would be at the operating level, between the trading desk and people in the market. But there would also be less frequent but more or less continuous contact between the policy-making officials and people in the market as to the course of the market and the effect which monetary policies were having in that market. Anyone, at any level of authority and responsibility, can sit in and listen in, or participate in the minute-to-minute or hour-to-hour or day-to-day contacts, if the situation is important or likely to grow critical, so as to have an immediate feel of what is going in the market. You do not have to sit in

[illegible] Federal Reserve Bank in New York itself. People from other parts of the [illegible] have come to, as observers; [illegible] but there has not been much [illegible] from [illegible] the Federal Reserve Bank of New York, either from other parts of the system or the market itself.

COMMISSIONER [illegible]: The [illegible] that take place, aside from the [illegible], [illegible] are those on all levels in the operation.

[illegible] [illegible] [illegible] in the market?

COMMISSIONER [illegible]: That is right.

MR. SIEGEL: [illegible] the ordinary course, [illegible] minute-to-minute and [illegible] [illegible] also [illegible] telephone would be at the [illegible] level, between the trading desk and [illegible] people in the market. But there would also be less frequent but [illegible] less continuous [illegible] between the [illegible] officials and people in the [illegible] to the [illegible] of the market and [illegible] [illegible], [illegible] were [illegible] [illegible] of authority and [illegible] [illegible] [illegible], or [illegible] [illegible] or hour-to-hour or [illegible] [illegible] [illegible] situation [illegible] [illegible] [illegible], so as to [illegible] [illegible] [illegible]

an upper office and wait for someone to come and tell you what is going on, if you want to find out for yourself.

COMMISSIONER MACKINTOSH: Mr. Sproul, on pages 11 to 13 you discuss the impact of international trends on policy, and you advance the view that if they are taken early enough the likelihood of conflict between external and domestic policy is reduced very substantially. I take it that you would agree that if they are not taken early enough and conflict develops, depending on the degree of the severity of the situation, the international considerations assume priority and may ultimately become mandatory?

MR. SPROUL: Yes. I think they are so clear and obvious and can become so critical in the running down of a country's reserves and the pressure on its currency that they have to be given temporary precedence over whatever domestic objectives you have in mind for the longer run.

COMMISSIONER MACKINTOSH: In the United States you had a long period when you could afford to ignore international influences, whereas by contrast in the 50's and 20's the British seemed to be periodically on the edge, with a very restricted range of choice. Is there any hope of easing this by central banks in other countries or governments carrying larger reserves?

MR. SPROUL: Giving themselves more leeway?

COMMISSIONER MACKINTOSH: Yes.

[illegible] upper office and wait for someone [illegible] come and tell you what is going on. If you want to find [illegible]

pages 1 to 12 you discuss the impact of [illegible] changes of policy, and you advance the view that [illegible] they are taken [illegible] the line [illegible] between external and domestic policy [illegible] substantially. [illegible] if they are not taken [illegible] enough [illegible] develops, depending on the degree of the severity of the situation, the international [illegible] assume priority [illegible] domestic [illegible]

MR. STAMP: [illegible] I think they are so clear and obvious and [illegible] decisive [illegible] turning [illegible] of a country's reserves and the [illegible] on its currency that they have to be given [illegible] precedence over whatever domestic objectives you have in mind for the [illegible]

CONGRESSMAN [illegible]: In the United States you had a long period when you could afford to ignore the [illegible] indifference, observed by [illegible] the [illegible] to be periodically [illegible] range of [illegible]. Is [illegible] by central banks [illegible] longer [illegible]

MR. STAMP: [illegible]

MR. SPROUL: Yes, I think that has happened to a considerable extent in the distribution of what might be termed the excess reserves of the United States to the countries of Western Europe, which have been able, since 1950, or thereabouts, when our balance of payments first went into deficit, and in a very large measure from 1958 on, to rebuild their reserves, so that most of the countries of Western Europe now have reserves which do give them some cushion with which to meet temporary pressures on their balance of payments and on their currencies.

[illegible]: Yes. I think that has happened to a considerable extent in the distribution of what might be termed the excess reserves of the United States to the countries of Western Europe which have been solely, since 1950, or thereabouts, when our balance of payments first went into deficit. In a very large measure from 1950 on to rebuild their reserves, so that most of the countries of Western Europe now have reserves which do give them some cushion with which to meet temporary pressures on their balance of payments and on their currencies.

The United Kingdom itself has made some progress -- although not nearly so much as these other countries have made in that regard. Its situation is still less comfortable, certainly, than that of some of the western European countries, and certainly less comfortable than ours, but considerable progress has been made in building up the reserves of a number of countries and in that way creating a greater stability in international financial relations. Looking back on it I think it was for that reason that we could look with equanimity on the deficit in our balance of payments, at least up to 1958, 1959 and 1960.

We were thinking that this was a desirable thing. We had reserves in excess of our needs, the other principal industrial and trading and financial nations of the world had inadequate reserves, and thus redistribution of reserves was a desirable thing from the standpoint of international monetary and international trading and financial arrangements.

We may have been a little slow in reacting to this situation, as it finally developed, because in the three years, 1958, 1959 and 1960, the movement of reserves became cumulative and disagreeably large. During much of the period when our balance of payments was in deficit, however, there was a desirable redistribution of reserves amongst the principal trading and financial countries. Theoretically and practically it gave a necessary underpinning to international financial arrangements.

COMMISSIONER MACKINTOSH: You seem to give approval to the various steps that were taken to stem this international situation in reducing the outflow of capital from the government account -- "Operation Nudge" and so on, and the higher short-term rate of interest. I gather you think on the whole that the action was taken in time. But, would it not be true that if you had had a narrower reserve margin it is quite possible these actions would not have been taken in time? In other words, you could see and watch for some time the trend in your reserves and examine the thing and arrive at a policy with a narrower margin of much less time to figure these things out?

MR. SPROUL: Yes, I think that is true. On the other hand, I think with a narrower margin we might have been less willing to enter into some of these world-wide commitments which we did enter into, and which now we find very difficult to get rid of, involving as they do a continuing and substantial outflow of capital on government account which other countries seem reluctant to take up, even though their reserve positions have greatly improved over the last few years. We think they might well give further support to the common international objective, and relieve us of some of this burden.

We did have time to examine our position and to begin to correct it before it was too late. On the other hand, as I say, I think the size of our reserves and the ability to ignore the pressure on our balance

COMMISSIONER M[illegible]H: You seem to give [illegible] to the various steps that were taken to stem this international situation or reducing the outflow of capital from the government accounts -- "Operation Nudge" and so on, and the higher short-term rate of interest. I gather you think on the whole that the action was taken in time. But, would it not be true that if you had had a narrower reserve margin it is quite possible these actions would not have been taken in time? In other words, you could see and watch for some time the trend in your reserves and examine the thing and arrive at a policy with a narrower margin of much less than the figure I [illegible] [illegible].

MR. SPA[illegible]L: Yes, I think that is true. On the other hand I think with a narrower margin we might have been less willing to enter into some of these world-wide commitments which we did enter into, and which had we then very difficult [illegible] of, involving us in the [illegible] and [illegible].

[illegible]

other countries were reluctant to take it, even

[illegible]

over the last few years, we think they [illegible] further [illegible] to the common interest [illegible] objective, and relieve us of some of the burden.

We did have time to examine [illegible] begin to correct it [illegible] we [illegible]. On the other hand, as I say, I think the size of our [illegible] the [illegible] [illegible] pressure on [illegible] [illegible]

of payments did lead us to assume burdens which we now find a little oppressive, and which nobody else wants to pick up if they can avoid it.

COMMISSIONER MACKINTOSH: At the bottom of page 12 you suggest that in your judgment it is about time to change the mix of fiscal and monetary policy, to reduce taxation and to raise interest rates a bit, and have a planned rather than an unplanned deficit. I take it the idea of the international situation could be held up by higher interest rates which would thus give a little more scope for expanding the domestic economy.

MR. SPROUL: That is correct.

DR. MACKINTOSH: Would you care to elaborate on that?

MR. SPROUL: I think as our balance of payments situation has developed over the past two or three years, and in the light of the actions that have been taken to correct it in the past two or two and a half years, we have gotten to the point where, aside from the continuing effort to get some wider distribution of the capital expenditures of government for international purposes, our particular Achilles' heel now is the outflow of private capital. I think that we could have a substantial influence on that by bringing our interest rates and particularly our short-term rates more nearly in line with rates of interest in other principal financial centres so that there would no longer be such advantage for foreign borrowing in our markets, and so that moving short-term funds abroad, either covered or uncovered would not longer be so attractive. From time to time, in fact, the flow

might be in the other direction. I think that would protect our economy against the remote, perhaps, but always existing possibility of a sudden deterioration in our balance of payments which might precipitate a crisis.

However, the position of the domestic economy is such - we are still not at what we consider to be the optimum level of production and the rate of unemployment is still above what is considered desirable - that a monetary policy which resulted in somewhat higher interest rates, would be inappropriate, both from the economic standpoint and from the political standpoint, unless there were some countervailing stimulant. In the present situation that could be provided by way of fiscal policy; by tax reduction.

I think that so-called easy money, which has been continued in this period of economic recovery for a longer time than in any similar post-war period, lost its thrust. It is no longer giving an observable stimulus to the economy. We could now give the economy that stimulus through tax reduction without fear that whatever temporary increase in the budgetary deficit which might result would run us into the danger of a recurrence of strong inflationary pressures. The countervailing force of idle men and idle capacity and the competitive pressure from the outside world would be our protection.

might be in the other direction. I think that, while [illegible] protect our economy against the [illegible], perhaps, but always existing possibility of a sudden deterioration in our balance of payments which might precipitate a crisis.

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whatever temporary increase in the liquidity [illegible] which might result would run into the danger of a recurrence of [illegible] [illegible]. The counteracting forces of [illegible] and [illegible] and the competitive pressure from [illegible] would be our protection.

I think such a policy has some elements of risk in it, but anything you do has elements of risk in it, and you have to take some risk in order to have a policy at all.

THE CHAIRMAN: Are there any more questions?

COMMISSIONER GIBSON: I have some questions to ask about the question of liquidity and near banks if you wish to go on with that aspect now, Mr. Chairman?

THE CHAIRMAN: Yes.

COMMISSIONER GIBSON: You have a very interesting section, Mr. Sproul, running from pages 13 to 15 in which you talk about the problem of liquidity and the question of near banks, and you end up by saying:

> "...the Radcliffe Report would have given a more balanced guide to those who may look to it for light and leading, if it had not tried to make such a basic theory case for liquidity, but had suggested that 'the authorities should not only control the supply of money, but also seek more broadly to affect the liquidity of the economy'."

You go on to say that the monetary authorities should seek better information and more understanding of the factors that influence liquidity rather than trying to acquire a measure of control over financial intermediaries.

I wonder if you would start off this subject

by saying a little more about what you think liquidity is, and how it ought to be regarded. How do you measure it? You talk about liquid assets. Can we go beyond that and discuss what effects there are on spending decisions? This is a pretty big order, but ---

MR. SPROUL: Yes, it is. Well, let me say -- and here I will ask the indulgence of Dr. Mackintosh -- that I think some economists got into the Radcliffe Committee and decided they were going to develop a new and rather striking theory of the goals and objectives and means of monetary policy. That led them to over-emphasizing greatly the liquidity of the economy as the thing you ought to be watching, and in the words of my former colleague, Mr. Roosa, I find this liquidity concept a most elusive one.

I agree with you. We do not know how to measure it. We have not the means of determining the liquidity of the economy, and the desires of various elements in the economy for more or less liquidity. I do not know, if we accepted -- although they hedge from time to time -- the recommendations of the Radcliffe Report, whether we would know what we were doing, or how we would do it. I do not think we would. Therefore, I say it is important. I think we should try to find out more about it, and to improve our knowledge of how changes in the money supply and availability of credit do work out in terms of the liquidity of the economy, but I do not think it can be a guide to monetary policy of any practical use in

the state of our present knowledge. My thinking about it comes down to this; that liquidity depends on a functioning money market. Assets are only liquid if they can be shifted to someone for cash, and when there are buyers who will give up cash in order to buy earning assets. The central bank and the commercial banks are the heart of such a money market. Our main reliance, so far as monetary policy is concerned, must be on affecting liquidity through the supply of money and the availability of credit in a properly functioning money market. This is what gives the economy the ability to shift assets around, both as between cash and earning assets and between earning assets of various maturities, at various prices and yields. This is what enables the economy to get what it desires in terms of liquidity. But I find it impossible to envisage a specific indicator of liquidity in the whole economy which would be a working guide for monetary policy.

COMMISSIONER GIBSON: But, you see, liquidity which, I take it, is an attitude, is influenced by various groups of assets of varying degrees of liquidity.

MR. SPROUL: That is right.

COMMISSIONER GIBSON: And the things you can measure are the assets. That is, if you can decide what are liquid assets and can apply some measurement ---

MR. SPROUL: And if you can decide what intermediaries in the process are adding to or subtracting from liquidity, which is another difficult problem.

[illegible]e state of our present knowledge. My thinking [illegible] but it comes down to this; that [illegible] liquidity depends on a functioning money market. Assets are only liquid if they can be shifted to someone for cash, and when there are buyers who will give up cash in order to buy [illegible] earning assets. The central bank and the commercial banks are the heart of such a money market. Our main reliance, so far as monetary policy is concerned, must be on affecting liquidity through the supply of money and the availability of credit in a properly functioning money market. This is what gives the economy the ability to shift assets around, both as between cash and earning assets and between earning assets of various maturities, at realistic prices and yields. This is what enables the economy to get what it defines in terms of liquidity. But I find it impossible to envisage a specific indicator of liquidity in the whole economy which would be a working guide for monetary policy.

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MR. [illegible]: And if you can decide what [illegible]ermediaries in the process are adding to or sub[illegible]ing from liquidity, which [illegible] another different [illegible]n.

COMMISSIONER GIBSON: But on this question of having liquid assets, however you define them, there is produced a feeling of liquidity which, in turn, induces a decision to spend, or losing such assets produces the opposite result. This is the sort of basic theory behind it, is it not?

MR. SPROUL: Yes.

COMMISSIONER GIBSON: How does liquidity influence spending decisions? Perhaps you might just talk on that a bit, because it might be very helpful to us.

MR. SPROUL: I will begin with the spending unit which is the household or the individual. If it has money in a savings account or it has holdings of savings bonds as a backstop then it might be more likely to spend larger amounts out of current income than if it had no backstop of liquidity in terms of these liquid assets.

COMMISSIONER WILSON: But on this question having liquid assets, however you define them, does [illegible] produced a feeling of liquidity which, in turn, induces a decision to spend, or losing such assets produces the opposite result. This is the sort of basic theory behind it, is it not?

[illegible]

just talk on that a bit, because it might be very helpful to us.

MR. [illegible]: I will begin with the spending unit which is the household or the individual. If it has money in a savings account or it has holdings of savings bonds as a backstop, then it might be more likely to spend larger amounts out of current income than if it had no backstop of liquidity, in terms of these liquid assets.

The second category of spending units, the business spending units, if they have liquid resources and will not be faced with having to go to the market -- under perhaps adverse conditions -- at some future time, may be more willing to enter into spending commitments, commitments of intermediate or long-term length, which they feel that they can carry without too great reliance on borrowing to bring to completion. It is a feeling of having some cushion, as in the case of international reserves, of having some cushion between yourself and a position in which somebody else can tell you what you have got to pay, what you have got to do in order to go on with a programme. I think that liquidity provides that sort of a backing for expenditure habits on the part of individuals and business units.

COMMISSIONER GIBSON: Styles change in this area from time to time, do they not? You have a long period when long term assets are fairly marketable; people get to regard these long term assets with favour, isn't this right?

MR. SPROUL: Yes, and that comes back to the ability of the monetary authority working through the money market to bring about some change in styles and attitudes. If it begins to appear that these long term assets are no longer as shiftable as they were -- when what you had come to consider a liquid asset, doesn't move as readily as it once did -- then your attitude can

begin to change. It seems to me that policy has to be built, in the beginning, on the most liquid asset, money, and to work up from there to the other assets of varying degrees of liquidity. If you make changes in the most liquid asset, the money supply you will begin to have some influence on the shiftability of other financial assets which are considered to have various degrees of liquidity.

THE CHAIRMAN: We will adjourn now until 2 o'clock.

--- Luncheon Adjournment.

--- Upon resuming at 2.10 P.M.

COMMISSIONER MACKINTOSH: We will resume our hearing. The Chairman is unable to be present this afternoon, and I think when we broke off Mr. Gibson had some points which he was pursuing.

COMMISSIONER GIBSON: Mr. Chairman, we were starting to talk about this question of liquidity, and I think we had got around to the question of how liquidity has increased and decreased.

I want to ask you a few questions here which will serve to open up these subjects. The primary control of liquidity, as you said, I take it, sir, is the control of the supply of money, bank demand deposits. Now, when you are controlling the supply of money, preventing the supply of money from increasing in response to a demand which is greater than the existing supply, you get this phenomenon to which you refer of an increase in the rate of turnover of money which is one of the reflections of an expanding demand. The monetary authority will not allow the money supply to go up with that demand, and this produces higher rates of interest and to some extent less availability, and this in turn stimulates velocity and brings in what we call near bank transactions which adds to the money supply or, in any event, its rate of usage.

MR. SPROUL: Yes.

COMMISSIONER GIBSON: Now, this reaction off-

sets the efforts of the monetary authorities to check an expansion. Would you care to say how serious you think this is?

MR. SPROUL: Well, I think it is serious in terms of trying to fit monetary policy, directed primarily towards the money supply, precisely to an existing situation in terms of volume and time. It is serious because it does involve an increase in use of credit, an increase in velocity of credit, which to some extent offsets your effect on the volume or credit, and creates a lag with respect to the effect of your action on the economy. But I don't think that means that you are permanently inhibited in exercising your controls. I don't think the ability of the users of money or credit to increase velocity is infinite; I think there are limits on the increase in velocity. The factors which set up the increase in velocity reach a limit when the desire to get out of money in to earning assets ceases, so that you are not working against a factor which has no limits. By increasing the amount of your pressure on the money supply, you can -- even despite the secondary effects of increased interest rates and increased attractions of liquidity instruments -- you can by reason of the lack of availability and non-price rationing of credit bring a halt to increasing expenditures. You can have an effect which will only be delayed and, to some extent, reduced by increased velocity of money and near bank transactions.

sees the effects of the monetary authorities to break an expansion. Would you care to say how serious you think this is?

MR. SPROUL: Well, I think it is serious in terms of trying to [illegible] monetary policy, primarily towards the money supply, precisely to get credit, [illegible] in terms of volume and time. It is serious because [illegible] use of credit, an increase in velocity of money which [illegible] of [illegible] your effect on the value of credit and [illegible] the effect of your action on the economy. But I don't think that means that you are permanently inhibited in exercising your controls. I don't think the ability of [illegible] of money or credit to increase velocity is unlimited. I think there are limits on the increase in velocity. The factors which set up the increase in velocity reach a limit when the desire to get out of money into earning assets ceases, so that you are not working against a factor which has no limit. By increasing the amount of your pressure on the money supply, you can -- even despite the secondary effects of increased interest rates and increased [illegible] forms of liquidity instruments -- you can reach the limit of the availability and convenience [illegible] of credit, bring a halt to [illegible] expenditures. You can have an effect which may only be delayed until, to some extent, [illegible] value of money and [illegible]

COMMISSIONER GIBSON: Well, would you agree, sir, that the high interest rates are pretty important in speeding up this use of idle moneys?

MR. SPROUL: Yes, for a time, as the money supply declines, but if the pressure is increased, the banks begin to have to sell some of their assets to non-banks in order to meet their own needs for liquidity, and their own desire to finance their commercial customers. And as they sell to non-banks it tends to put a stop to this rise in velocity and eventually to reverse it if the pressure is continued long enough. Action taken to reduce the money supply affects the price of government securities, and that effect spreads to corporate securities and to other financial assets. Yields increase but prices decline and the liquidity of the whole system is reduced, so there is a limit to the extent to which the movement can go.

For instance, as I read its report, I think that the Radcliffe Committee left the impression that there was no limit to the increase in velocity of money and very little limit to the liquidity preferences of the community, and I think there are limits to both which can eventually be reached by working on the most liquid asset, which is money.

COMMISSIONER GIBSON: Is there a danger that by the time such a policy starts to take you will have had too great a monetary expansion through the vehicle of velocity?

MR. SPROUL: That does introduce an element of difficulty with respect to timing. If your action has been delayed too long in terms of the development of the business cycle, when you finally take action an increase in velocity, a more actively used credit supply can carry on a monetary expansion, you have lost some ground in terms of controlling the economic development you were trying to control.

COMMISSIONER GIBSON: Suppose you found, sir, that if after we got better information -- as you recommend -- a better understanding about this process, and certainly I need a lot better understanding of it, suppose we had come to the conclusion that this is a serious problem and that there is a lot of elasticity to this velocity, and to this secondary credit creation, what sort of controls, what sort of devices to control this would you think of? Or, if this is not a fair question, please say so.

MR. SPROUL: Well, I don't know of any device or controls that I would be willing to advocate or try to apply, because the concept of liquidity is so elusive, the areas where increased velocity can take place are so many and the difficulties of applying any control would be so great. For the present I would find it congenial to continue working with the imprecision

[illegible] COMMISSIONER: [illegible]

by the time such a policy [illegible] to take you will [illegible]

have had the speed [illegible] extension [illegible]

[illegible] of velocity?

[illegible] that [illegible]

[illegible] difficulty [illegible]

has been [illegible]

of the hundred [illegible] cycle, [illegible]

so [illegible] in velocity [illegible] more activity [illegible]

supply can carry on [illegible]

left some ground in terms of [illegible]

development without fading, to control.

[illegible]

that [illegible] we get [illegible] to [illegible]

[illegible]

but [illegible] I [illegible] better understanding [illegible]

supposed [illegible]

certain [illegible]

velocity, and to make secondary [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible] I [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

of the tools of monetary policy we now have, trying to improve our knowledge of the liquidity factor before any new controls are advocated or requested.

COMMISSIONER GIBSON: I suppose you regard debt management as one of the implements here that could be used to increase or decrease liquidity in the system?

MR. SPROUL: Yes, to some extent it could be so used, depending on the kind of financing which the government was able to successfully develop;

but I don't think that would be a more flexible and timely weapon than existing monetary policy.

COMMISSIONER GIBSON: And you wouldn't think in terms of major refunding operations designed to lengthen materially the national debt?

MR. SPROUL: I think refunding operations to lengthen the maturity of the national debt are doing pretty well if they prevent a shortening of maturity with the passage of time. You have to run to "stay where you are at."

COMMISSIONER GIBSON: That is all I have.

COMMISSIONER MACKINTOSH: Are there any other questions in this field?

COMMISSIONER BROWN: I would like to ask one question, and that is that as newer and more institutions develop in the system, which have this

tendency to act as a velocity increaser, does this mean that the monetary authorities when they come to do anything have, in fact, to take more drastic action than they would otherwise?

MR. SPROUL: I don't think that the financial intermediaries, as I suggested in my memo, the ones that are most often talked about, add a great deal to velocity.

The ones that add most to velocity are the ones which are so much dependent themselves on the banking system for financing, that they are reached rather quickly by present monetary measures; the finance companies, for instance, and those that extend trade credit, and all those that create instruments which can be quickly and conveniently, and without risk of loss, converted from cash to earning asset, or from earning asset to cash. They themselves respond pretty quickly to pressure on the banking system on which they depend to a considerable extent. On the other hand the insurance companies, the pension funds, the trust funds, don't create much velocity; they deal in savings at different rates, at different times, but I don't think that either in the cyclical sense nor in the long term sense they contribute greatly to velocity as an influence opposed to the influence of monetary policy.

Of course, as interest rates are going up and attracting idle funds into liquidity instruments, prices are going down and the value

[illegible] no rel as [illegible]

that the monetary authorities when they come to anything here. In fact, [illegible] take more [illegible] [illegible] than they would [illegible]."

MR. [illegible]: I [illegible] think that the financial intermediaries, as I suggested [illegible] [illegible], [illegible] that are [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]

The ones [illegible] [illegible] [illegible] and the ones which are so much [illegible] [illegible] themselves in the [illegible] system [illegible] [illegible], [illegible], the [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]; the finance companies, [illegible] [illegible], and those [illegible] [illegible] [illegible] [illegible], and all those that create liquid [illegible] can be quickly [illegible] conveniently, and without [illegible] loss, converted from [illegible] to earning asset, or from earning asset to cash. They themselves [illegible] [illegible] [illegible] to [illegible] [illegible] [illegible] banking system on which they depend to a considerable extent. On the other hand the insurance company, the pension funds, the trust funds, don't create much liquidity; they deal in savings at different [illegible] [illegible] [illegible], [illegible] I don't think [illegible] [illegible] in [illegible] [illegible] sense [illegible] [illegible] the long term sense they [illegible] [illegible] [illegible] [illegible] [illegible] so [illegible] [illegible] [illegible] [illegible] monetary policy.

Of course [illegible] [illegible] [illegible] [illegible] and affecting [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] are going [illegible] [illegible] [illegible]

of all financial assets is going down, introducing an element into the complex which has retarding effects on velocity. The holders of financial assets are seeing the price of their holdings go down as the interest rate goes up and that has, I think, some countervailing influence as far as an increase in velocity is concerned.

COMMISSIONER LEMAN: I am just wondering if I understand completely what you are telling us in this field. Suppose in your economy you have institutions which finance partly or wholly through the acceptance of demand deposits from the public. Do you still consider that just that fact does not make a case for monetary control over them?

MR. SPROUL: They can accept demand deposits from the public, but can they also make loans to the public which they set up on their books as demand deposits?

COMMISSIONER LEMAN: Well, perhaps not, not in that sense, but they accept demand deposits and make loans, we will say.

MR. SPROUL: Well, we only have a variation of that; the savings banks are not supposed to accept demand deposits, although their deposits are pretty much withdrawable on demand. The savings and loan associations don't accept deposits at all; they sell shares, although the shares can be redeemed pretty much on demand. In any case they are largely taking

in and paying out savings, they are not increasing the total supply of money in the way that a commercial bank does through setting up a deposit on its books as the other side of a loan transaction.

I see a difference there, in terms of contribution to velocity and, by the same token, in the ability of the monetary authorities to reach their intermediaries directly and immediately by monetary action.

As I state here:

> "---the total supply of liquidity assets in the market and the fluctuations in that supply may be said to depend upon (1) increases or decreases in the money supply, (2) the flow of savings out of current income"

Which would be in your proposition the flow of savings out of current income into these deposit accepting institutions, which are not the commercial banks:

> "-- and (3) the net movement of funds out of or into idle balances - the velocity of money factor."

And by operating on the money supply, the authorities can attempt to compensate for undesired changes in the other two sources of liquidity and for liquidity fluctuations;admitting that there is a lack of precision in time and volume which we haven't been able to avoid, and which I don't think we are in a position to try to avoid by increasing our controls over financial intermediaries. That is an area where there has been

in institutions out of savings, they are not increasing the total supply of money, in the way that a commercial bank does through setting up a deposit on its books as the other side of a loan transaction.

I see a difference there, in terms of contribution to velocity and, by the same token, in the ability of the monetary authorities to reach these intermediaries directly and immediately by monetary action.

As I stated before:

"[illegible] today the supply of liquidity assets on the market and the fluctuations in that [illegible] may be said to depend upon (1) increases or decreases in the money supply, (2) the flow of savings out of current income"

Which would be in good proportion the flow of savings out of current income into these deposit-accepting institutions, which are not the commercial banks;

"-- and (3) the rate of movement of funds out of or into idle balances -- the velocity of money factor --"

And by operating on the money supply, the authorities [illegible] the other two [illegible] [illegible] [illegible] [illegible] in by increasing or [illegible] [illegible]

a great deal of adaptation and improvisation, and my guess is that if we tried to put in controls on the basis of our present knowledge, the intermediaries would find new methods and new ways of operating which would make our controls obsolete. It has been suggested that we could get through to them by regulatory controls, requiring them to hold reserves which could be increased or decreased in the light of the business situation, to supplement present controls over commercial banks. Something of that sort might be desirable in terms of competitive equity, but I am discussing here the effectiveness of monetary policy and the ability to reach through this area of intermediaries to changes in money velocity. I don't think we have the basis for effective controls and workable controls which would justify our seeking the power.

COMMISSIONER LEMAN: Well, in terms of lags, the existence of this kind of shifts and transfers and the use of available credit in the economy, and in terms of the lags, when you talk of the speed or effectiveness of the action, would you think that this would be an influence there?

MR. SPROUL: Well, as I was saying, I think the institutions which now contribute most to changes in the velocity of money are already so tied in with the commercial banking system that we get to them fairly quickly. As for the other institutions which I think contribute a lesser amount, it wouldn't be a great contribution to our precision and timing

a great deal of adaptation and innovation, and my guess is that if we tried to put in controls on the basis of our present knowledge the intermediaries would find new methods and new ways of operating which would make our controls obsolete. It has been suggested that we could get through to them by regulatory controls, requiring them to hold reserves which could be increased or decreased in the light of the economic situation to supplement present controls over commercial banks. Something of that sort might be feasible in [illegible] competitive economy, but I am discussing here the effectiveness of monetary policy and the ability to reach through this area of increased ability to compensate in money velocity. I don't think we have the basis for effective controls and workable controls which [illegible]

COMMISSIONER TURNER: Well, in terms of [illegible] the existence of this kind of saving and transfer and the use of alternative credits in the economy and in terms of the Fed, when you talk of the speed of effectiveness of the system, would you think that this would be an influence there?

MR. SPROUL: Well, as I have said, I think the institutions which now contribute most to changes in the velocity of money are already so tied in with the commercial banking system that we get to them fairly quickly. As for the other institutions which I think contribute a lesser amount, it would be an [illegible] contribution to our [illegible] and [illegible]

if we tried to get direct controls over them.

COMMISSIONER GIBSON: Suppose you didn't have direct controls or variable controls, would a device that set sort of minimum liquidity standards be helpful just so you would know they couldn't run down your liquidity beyond a certain point?

MR. SPROUL: My present inclination is to view that as a matter of business judgment in those areas and in those institutions. They are in a different category from the commercial banks, where a franchise to create the principal payment medium of the country is being exercised and where you have important grounds for demanding an adherence to liquidity concepts which, at times, might not be suggested by the particular private interest involved. The same consideration does not apply to these intermediary institutions; they haven't been given the franchise of creating the principal circulating medium of the country, but they can be kept under some sort of reasonable restraint through monetary policy so far as their liquidity is concerned.

COMMISSIONER MACKINTOSH: We had a different approach suggested by a witness from Britain. As I understood him, he said that in a period of fairly severe credit restrictions on the clearing banks that various financial intermediaries were able to attract deposits away from the banking system and to carry on financial transactions which the clearing banks under the circumstances found impossible to carry on, and I understood him to represent that on the grounds of equity -- if upon no other grounds -- he thought controls would have

to be extended.

MR. SPROUL: As I see it, it would have to be on grounds of competitive equity if the controls were extended, and not on grounds of necessity in order to make monetary policy effective. And on the question of competitive equity I think, in our situation, this is perhaps more a matter of taxation rather than of reserve requirements or liquidity requirements being fixed by law or regulation.

COMMISSIONER MACKINTOSH: There may be some difference in that but my recollection is that many of your banks carry on a considerable trust company business whereas our trust companies are separate; they tend to develop a banking business, so that yours are inside the system and much of that business with us is outside.

MR. SPROUL: That may be; Many of our banks do carry on a trust business. Is there a combination of savings bank and commercial bank business in your banking system such as we have?

COMMISSIONER MACKINTOSH: Yes.

MR. SPROUL: Because outside the principal eastern financial centres most of our banks are very substantially savings banks as well as strictly commercial banks.

COMMISSIONER MACKINTOSH: Well, ours are I would think even to a greater degree than yours.

COMMISSIONER LEMAN: Following on from where Mr. Gibson stopped, we begin to approach the question of lags in the way monetary policy operates from page 16 on, but one sentence near the bottom of page 16 reminds

me to go back to another one on page 4, where you are mainly dealing with objectives, and where you have said:

> "...there can be no check-plots in a dynamic, growing economy by means of which you can isolate and compare the effects of monetary policy and no monetary policy."

And then on page 16 you say:

> "   Nor is it given to us to be able to foresee accurately and completely how a change in monetary policy will make its way through the economy."

Now, "accurately and completely" would imply that you can foresee quite well, if not accurately. Are you being a little generous to the cause of how monetary policy acts through the economy, in view of what you said earlier that you can't measure what would have happened if you had not ever taken the action?

MR. SPROUL: I may be a little generous to the monetary authorities there; I may have in mind combatting critics such as one of our professors, Mr. Freidman, who thinks our policies have always been wrong and that whenever we acted we did the wrong thing and got perverse results, and implies that if we had been relating the supply of money constantly to some rate of growth in the economy or to the Gross National Product we could have done better. So I may be a little generous to the monetary authorities there, but I was trying to protect my former colleagues

against the demand that their actions result in perfect timing and perfect results.

I don't think that is possible by monetary action alone nor by monetary action in harness with fiscal action and debt management.

I don't think it is possible, first, to combine all the elements of this problem into a perfect synthesis and then to foresee exactly how your actions will move out through the whole economy. But I don't think that economies which are more planned than ours / have been able to solve that problem either; in fact, as they have proliferated their plans and their controls, they have found that they always needed one more control to make their plans work and that, finally, that they needed to harass and to direct considerable bodies of their citizens to do things they didn't want to do in order to try to make the results agree with the projections.

COMMISSIONER LEMAN: You extend in that section the forces necessary to monetary control, and you say that forecasts must be made and estimates of economic reactions must be attempted, and then you go on -- I will not quote you -- but you go on and say that if you do something at the right moment you save yourself a lot of trouble later on in having to be too harsh in the measures you have to take. Then you tell us that, of course, you can't be too scrupulous about fairness in this process because it is recognized that the effects of what you do do not necessarily lie fairly on the various sectors of the

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I don t think that is possible by monetary action alone nor by monetary action in harness with fiscal action and debt management.

I don't think it is possible, first, to combine all the elements of this problem into a perfect synthesis and then to foresee exactly how your actions will move out through the whole economy.

But I don't think that economies which are more planned than ours have been able to solve that problem either; in fact, as they have proliferated their plans and their controls they have found that they always needed one more control to make their plans/finally work and that, that they needed to harness and to direct considerable bodies of their citizens to do things they didn't want to do in order to try to make the results agree with the projections.

COMMISSIONER LYMAN: You extend in that section the forces necessary for monetary control, and you say that forecasts must be made and estimates of economic reactions must be attempted, and then you go on -- I will not quote you -- but you go on and say that if you do something at the right moment you save yourself a lot of trouble later on in having to be too harsh in the measures you have to take.

Then you tell us that, of course, you can't be too scrupulous about fairness in this process because it is recognized that the effects of what you do do not necessarily lie fairly on the various sectors of the

economy. Can the monetary authority also foresee large sectors which will be more or less hampered or hurt by whatever action is taken?

MR. SPROUL: Well, it has been claimed -- I don't think it has been seen wholly clearly -- but it has been claimed and with some evidence to support it that in periods of monetary restraint small business is more restricted than large corporations and that municipalities are more restricted in their borrowing than some other applicants at the lending window. I think there is some truth in that, although not as much as those who press the argument are apt to claim. But when you have reached a point in your restrictive policy where these, perhaps, inequitable results begin to appear, it may be one of those necessary reallocations of resources which is desirable in terms of getting the whole economy back on the right track.

Some marginal claims for credit will be shut out if you adopt a restrictive policy, and I don't think you can expect the restriction to apply equally to every possible borrower under every possible form of a loan transaction.

You have to adopt the general attitude that the over-all ~~benef~~ it outweighs the temporary inequity with respect to special groups.

COMMISSIONER LEMAN: I asked that question, sir, because we have heard some people come before us and argue that certain types of credit were more inflationary in character than other types of credit; credit used for certain purposes in itself is more

inflationary than others. It could be disputed, I suppose, but are you telling us now it is not in the nature of a fact that the action to correct certain tendencies would naturally fall on those who were creating those undesirable tendencies, but it doesn't work that way.

MR. SPROUL: Well, I wouldn't want to claim that all of the -- in a period of restrictive action -- that all of the restriction fell on exactly the areas where the most undesirable uses of credit are taking place, but I think in general they will fall at the margin and the fringes of credit use, where in terms of the best allocation of resources of the economy you will get the results you are seeking.

I have the feeling that -- to paraphrase Mr. Lincoln -- if you try to protect all of the people all of the time from the results of action to correct economic excesses, you will never have a policy; you are going to be undoing with one hand what you are doing with the other, subsidizing one group of the population while you are trying to restrain another, in an effort to find a perfect balance in a situation which doesn't permit it.

COMMISSIONER LEMAN: And that takes us back to what you told us earlier about selective controls?

MR. SPROUL: Yes. There is one area where you can say there is a departure from the general rule.

Selective control of consumer credit would allow you to get directly at one use of credit which has shown elements of instability so far as

the business cycle is concerned.

COMMISSIONER MACKINTOSH: Are there any other questions in this area?

I have some questions which I would like to ask you on another subject. You explain on page 18, I think it is, your views about the function and the service of a part-time board of directors. You have a federal system and we have a single central bank, which makes some difference. I have noted what you had to say about their importance in the matter of operating performance; what you might call corporation housekeeping. You say they have no advance knowledge of monetary decisions under the system. Now, we have had some rather extreme examples put before us by people familiar with central banks in other countries. In one case the inference I drew was that the governor gave his board just enough information to make reasonably probable that they would support him!

The other example was virtually a wide open debate on what view ought to be taken and what ought to be done about monetary policy, and the outcome of the debate was by no means certain.

Now, assuming that there is a single central bank, where would your view lie in that spectrum; how important or how helpful can your part-time board of directors be in matters of monetary policy?

MR. SPROUL: With a single central bank my opinion would be that you could lay before the directors an estimate of the economic situation as you and your economic staff see it, and ask for their views

and opinions as to the correctness of the estimate of the economic situation and their views and opinions as to what, if anything, should be done about it in terms of the continuance or change of existing monetary policy. You need attempt to seek a consensus or to get anything equivalent to a vote from such a board as to what should or should not be done; the decision should then be made by the senior officer of the central bank in consultation with the financial officer of the government.

COMMISSIONER MACKINTOSH: In other words, they can contribute substantially towards the understanding of the problem, but ought not really to participate in the decision?

MR. SPROUL: Not in making the final decision. We have protection there in the existence of our Federal Open Market Committee and the Board of Governors.

This gets away from your question as to a single central bank, but our part-time members of the boards of directors at the reserve banks can discuss these problems of the state of the economy, and of the direction in which it is going, and of the possible need or desirability of action in the monetary field, but the decision process is not there. When you go to the Federal Open Market Committee with respect to open market operations, or go to the Board of Governors with respect to the discount rate or reserve requirements, these private directors can have no foreknowledge or no certain foreknowledge of what the decision is going to be, and their partial

knowledge would be just as likely to be a handicap to them as a help to them in making improper use of what they have learned at the Federal Reserve Bank.

COMMISSIONER MACKINTOSH: And the governor or president of a Federal Reserve Bank who is on the Open Market Committee never is instructed.

MR. SPROUL: He is not an instructed delegate; he is a member of a statutory body with statutory responsibilities of his own as an individual, and is not bound by anything directors may have said or anything he may have said to them; he may go with one set of ideas in mind and after the discussion and argument and debate in the Open Market Committee he may come to a different conclusion, quite possibly, from the one he had in mind when he left his own bank.

COMMISSIONER MACKINTOSH: Well, it is something we couldn't imitate. I understand that there are three members of each board of directors who are appointed by the system?

MR. SPROUL: Appointed by the Board of Governors at Washington, yes.

COMMISSIONER MACKINTOSH: In the experience of the system has this had special importance?

MR. SPROUL: No, they tend to become individual members of the whole board of directors, not representing a particular point of view. The Board of Governors doesn't always put the same sort of people on the Board of Directors as those that are elected by the member banks; we are more apt to get, say, a university professor among the appointees from the Board of Governors or

[illegible]owledge would [illegible] part of [illegible] a [illegible] to [illegible] a bolt [illegible] what they have learned [illegible] Conditions [illegible]

[illegible] and the [illegible] president of a Federal Reserve Bank [illegible] upon Market Committee [illegible].

MR. [illegible]: He is not [illegible], he is a member of a statutory body with [illegible] responsibilities of his own as an individual, is not bound by anything directors may have said or anything he may have said to them; [illegible] one set of ideas in mind, and after the discussion [illegible] and debate at the Open Market Committee [illegible] come to a different conclusion, quite [illegible] the one he had in mind when he left his own bank.

COMMISSIONER [illegible]: Well, [illegible] something we couldn't [illegible]. I understand that there are [illegible] board of directors who are appointed [illegible].

MR. [illegible]: [illegible] by the board [illegible]

[illegible]

COMMISSIONER [illegible]

[illegible] the system [illegible]

MR. [illegible]: [illegible]

members of the [illegible]

[illegible]

always [illegible] the same [illegible]
[illegible]
[illegible] that are [illegible]

[illegible]

some one who is not directly in banking or business, but in general they become working members of the whole board of directors and are not distinguishable from the other members of the board.

COMMISSIONER MACKINTOSH: You force me to drop my next question, which was whether the arrangement led to the appointment of directors of higher calibre in this category! You have out-guessed me.

MR. SPROUL: I think I did.

COMMISSIONER MACKINTOSH: Are there any other questions on that document?

Then, I think you had some questions Mr. Brown?

COMMISSIONER BROWN: Yes. I have one or two questions, Mr. Sproul. We mentioned just briefly this morning the concept of clear signals, and it wasn't entirely in the context, but I asked you at that time about it.

I gather that there are some reservations on this in the sense that you outline on page 20, when you were talking about the activities of central bank directors, and you say:

> "First, it was recognized that in our political framework the exercise of the monetary authority, delegated by the Congress to the Federal Reserve System, could not be exercised in camera, if the System was to retain its powers and its being. Second, it was rightly decided that a central bank's authority

a one who is not directly in banking or [illegible], but in general they become [illegible] members of the whole board of directors and are not distinguishable from the other members of the board.

COMMISSIONER MACKINNON: You [illegible] drop my next question, which was whether [illegible] led to the appointment of directors of [illegible] in this category. [illegible]

MR. SPROUL: I [illegible]

COMMISSIONER MACKINNON: [illegible] other questions on that [illegible]

Then, I think [illegible]

COMMISSIONER EMMET: Yes. I [illegible] two questions, Mr. Sproul. We mentioned [illegible] this morning the [illegible] wasn't entirely in the [illegible] I asked [illegible] short time about it.

[illegible] there [illegible] on this in the same [illegible] when you were talking [illegible] bank directors, [illegible]

"Since, [illegible] political [illegible] monetary [illegible] Congress to the [illegible] could [illegible] the System [illegible]

"grows out of building up the widest possible interest in and responsiveness to central bank actions."

Will you outline for us your concept of this reservation of clear signals?

MR. SPROUL: What I had in mind there was that from the beginning -- and it has grown and developed over the life of the system -- we have collected, developed and published facts and figures concerning our operations from day to day and week to week which are available to any one, and with a modest knowledge of banking and finance anyone can make some reasonable interpretations of what we are doing and what we are trying to do. But I would separate that from announcements or statements or the adoption "rules of the game", or public statements that now we are going to apply a policy of restraint to accomplish a certain purpose and a certain thing within a certain time. My purpose is to avoid an attempt to mechanize the actions of the Central Bank in what / I think would be an impossible attempt to tell the public more than we know ourselves at the time.

When we are faced with this difficulty of lags and how our actions will permeate the whole economy, I would ordinarily rather have the public interpret our actions from the figures we publish from week to week rather than try to tell the public what we are doing by the adoption of rigid rules or specific statements of policy programmes and objectives, which we ourselves couldn't adequately document.

COMMISSIONER MACKINTOSH: You are prepared to

say what you are doing, but you leave it to the public to figure out what you think you are going to accomplish by what you are doing?

MR. SPROUL: We are prepared - here is a modification -- we are prepared to let the public see what we are doing by telling them everything that we are doing in our published statements, our frequently published statements; we let them see what we are doing and let them make their own interpretations of what we are trying to do.

There are times when a speech or a pronouncement by some one in the system, which doesn't carry what I would call the stigma of a fixed rule or a definite commitment as to the extent and timing of our policy, can give a lead in the interpretation of the facts and figures which we make public, but generally we let our actions speak rather than rules and pronouncements.

COMMISSIONER LEMAN: You wouldn't say that this week we are just probing and withdrawing?

MR. SPROUL: No, next week we withdraw and then probe.

COMMISSIONER BROWN: The second question I have here is on this question of moral suasion. You mention it on page 21, but I am not quite clear whether you are against it because it has failed in practice, or whether you are against it as a point of principle.

MR. SPROUL: Both. I think in our case it has failed in practice and I am against it on a point of principle; when it has been tried I have observed that the members

of the community who are most responsible are also most responsive to exhortation by authority to do this and do that, and the people who are not responsive find ways of avoiding and acting upon exhortation of the authorities. you get your results in the wrong places even more than when you are operating through ordinary central banking channels.

COMMISSIONER BROWN: On the other hand, earlier this morning when we were discussing consumer credit and the mortgage credit, you suggested that if the powers were there that you could probably induce co-operation; do you put this to a little further stage than this moral suasion?

MR. SPROUL: A stick behind your back is more than moral suasion, I think. If you are just talking to them and just trying to get them to do something that you haven't any power to force them to do, then I think you are apt to have either no results or results in the wrong place.

COMMISSIONER BROWN: Would you class that as moral suasion?

MR. SPROUL: It tends to deteriorate into immoral suasion!

COMMISSIONER BROWN: That is all I have.

COMMISSIONER MACKINTOSH: Any others on that?

I think you had some further questions, Mr. Gibson?

COMMISSIONER GIBSON: No, I don't think so, Mr. Chairman. Mr. Sproul has really answered the further questions I had.

COMMISSIONER MACKINTOSH: Well, I also had some questions on the techniques, but I think they have been pretty well answered in our discussions.

Are there any further matters that the members of the Commission wish to take up?

If not, I on behalf of the Commission and the Chairman, Mr. Sproul, thank you very much indeed for the great help you have given us and the neighbourly generosity in which you have given it. Your memorandum has been very helpful to us and the expansion of it which you gave in this discussion has been equally helpful, and we are very grateful for the time and effort that you have contributed.

MR. SPROUL: Thank you. I have been delighted to come here and meet with you, and I have found it a stimulating experience.

COMMISSIONER MACKINTOSH: Thank you. The session is adjourned now and we will meet tomorrow morning at 8.45 to hear the Canadian Retail Federation.

--- Adjournment.

COMMISSIONER [illegible]: [illegible]

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been greatly well [illegible] in our deliberations

Are there any further questions [illegible]

f the Commission [illegible] to ask [illegible]

If not, I on behalf of the Commission and

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Royal Commission on Banking and Finance

MR. A. SPROUL
(Brief)

Hearings held at
OTTAWA

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STATEMENT OF ALLAN SPROUL

SUBMITTED TO

ROYAL COMMISSION ON BANKING AND FINANCE

OTTAWA, CANADA

- - - - - - - - - - -

September 27, 1962

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You have asked me to assist you in your examination of the structure and methods of operation of the Canadian financial system, and you have wisely excused me from trying to comment upon features of the system which are unique to Canada. You also emphasized, in your invitation, that in seeking my testimony you were looking to my practical experience as a central banker. That excuses me from the demands which you might make of a professional economist and limits the area in which I shall try to distil something from experience.

The first general subject in which you said you would be particularly interested is the objective of central bank policy. This, of course, is ground with which you are now familiar and my brief definition contains no surprises. The objective of monetary policy, running in harness with other governmental economic policies and controls, is to promote sustainable economic growth, high levels of production and employment, international balance and price stability.

Monetary policy attempts to achieve its objective by regulating total supply of money, and influencing the cost and availability of credit, allowing the market to determine in ways which are largely impersonal, the allocation of credit to various borrowers for various uses. In the broadest terms, a general monetary policy, along with fiscal policy, attempts to regulate effective demand for the output of the economy -- the demand-pull of the economic diagrams, although its

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influence also trickles through to the cost-push area.

Such a definition and such a statement of general method, of course, raise questions rather than answering them. The compatibility of maximum employment and production with stability of aggregate prices? The inability of monetary policy effectively to reach through a complex of economic forces so as to help to regulate the cost-push influences of the economic diagrams? The need for a means of co-ordination of monetary policy and other governmental economic policies, particularly in the areas of taxation and debt management, if each is to make its appropriate contribution to the shared objective? The relative weights to be given to the needs of the domestic economy and the disciplines of the international balance of payments? The place in the whole scheme of things of "near money" and "near banks," or the question of the money supply versus the liquidity of the economy? The lags in and the magnitudes of the responses tc nonetary controls, which rob them of that precision which perfectionists deem essential or seem to demand? These are the materials for a book, but that is what you will be writing when these hearings are completed. I can merely make some comments along the way.

First, let me affirm my continuing belief in the efficiency of monetary policy for its purpose. One of your Canadian exports to the United States, in a widely read treatise, has given a chapter to the "Monetary Illusion", in which he expounds the charm

which this mysterious thing called monetary policy has for those who are privy to its practices, and whose affection for it is translated into claims for its effectiveness which invade the supernatural. No other economic policy, he says, has ever shown such capacity to survive failure, to be hailed as a success. I reject this indictment. It springs from over-concentration on the argument that inflation may arise from other causes than "too much money chasing too few goods," and that monetary policy alone or combined with fiscal policy cannot get at these causes, except in ways which are too dangerous or politically impossible to use.

This is witty and misleading. The claims of monetary policy adherents are not so exorbitant. The function of monetary policy is to regulate the total supply of money and to influence its use, so as to help to keep the marginal demands of the economy -- government and private -- from spending themselves in speculation and increased prices in times of prosperity and from being stifled in times of recession.

A restrictive monetary policy affects demand chiefly through (1) raising the cost or price of credit, (2) lessening the availability of credit - the non-price rationing of credit practised by lenders in times of restraint, and (3) altering the expectations of investors and consumers, lenders and borrowers, as to the future course of the economy and, therefore, of incomes, prices and profits.

A policy of monetary ease has the reverse effect, helping to encourage expenditures by bringing

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This is wrong and misleading. The claims of monetary policy adherents are not so exorbitant. The function of monetary policy is to regulate the total supply of money and to influence its use, so as to help to keep the aggregate demands of the economy -- government and private -- from expanding excessively in speculation and increased prices in times of prosperity, and from being stifled in times of recession.

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about a lowering of the cost of credit and increasing its availability through the relaxation of non-price rationing, and by relieving concern about the future course of the economy, at least on the score of a lack of credit. Here, however, a qualification is necessary. A policy of monetary ease can only be effective if the profitability of investment has not generally and seriously deteriorated and if inventories are not excessive in relation to prospective sales. If a down-town reaches the cumulative stage, fiscal policy, government tax and spending measures, are the proper medicine.

To be sure, there is considerable disagreement as to the sensitivity of expenditure, and more particularly investment expenditures - whether for inventories, plant and equipment, government undertakings - to changes in the money supply and in the cost and availability of credit, and concerning the effect of changes in credit policy upon market anticipations. There is no way to settle the argument conclusively, because there can be no check-plots in a dynamic, growing economy by means of which you can isolate and compare the effects of monetary policy and no monetary policy. Until facts are more readily obtainable, and their interpretation more refined, and computers supplant man, we have to rely to a considerable extent on what our senses tell us. But common sense and informed judgment, particularly in dealing with matters so tinged with the vagaries of human beings as the workings of our economy, are an important part of

bout a lowering of the cost of credit and increasing its availability through the relaxation of non-price restrictions, and by relieving concern about the future course of the economy, at least on the score of a lack of credit. Here, however, a qualification is necessary. A policy of monetary ease can only be effective if the profitability of investment has not generally and seriously deteriorated and if inventories are not excessive in relation to prospective sales. If a down-turn reaches the cumulative stage, fiscal policy, government tax and spending measures, are the proper remedy.

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understanding and a necessary base of action. Monetary policy, particularly as expressed in open market operations, fits nicely into this still somewhat obscure area. It can probe and withdraw, apply pressure and relax pressure in varying degrees, test the substance of an economic movement or a structure of interest rates without final commitment. It is suited to its environment.

With this general affirmation of belief out of the way, I shall touch briefly on the questions I mentioned with respect to the objectives and methods of monetary policy and express some personal opinions about them.

The debate about the compatibility of maximum employment and production with price stability may not be quite so lively now as it was a short time ago, when post-war inflationary pressures were still strong but, mainly, it has changed its focal point. Whereas before the spotlight was on rising prices, now it is on persistent levels of unemployment which are deemed to be larger than is economically or socially desirable. The underlying question remains. In an economy such as ours, will business accept the risks and make the investments which are necessary to the development of the highest possible levels of production and employment, except in a climate of inflation, in some degree, which underwrites to some extent the possibility of profits in money terms. And will labour settle down to a fairer division of the rewards of increased productivity, as between stockholders, workers, and

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consumers, than it has been willing to accept in the years when increased costs could be translated into increased prices without killing the goose.

We do not have the whole answer. I suggest two partial answers. First, as is often the case, we may now be too much influenced in our thinking by the events of the recent past to have a balanced view of the possibilities of the approaching future. In the circumstances of excessive liquidity in the economy and of a pent-up demand for a wide variety of goods and services, which followed upon the war years, and with an aggressive labour movement striving to wipe out the restraints of war-time controls, we may have given too much credence to the idea that our economy generates inflationary pressures which cannot be controlled except by such drastic measures of monetary policy as would seriously hamper economic growth. It may well be that, with less liquidity in the economy and a less insistent demand for everything, and with a labour movement which is gradually, if slowly, coming to some sense of responsibility for its economic environment, high level production and employment and stability of aggregate prices can find common ground.

Second, admitting that there are certain rigidities in the economies, a certain inflexibility downward of prices and wages and a certain lack of geographical mobility in the labour force and in its adaptation to the need for new and different skills, which predispose us to some ratcheting upward of prices, we can seek other means of alleviating these non-

monetary pressures without abandoning the efforts of monetary policy to promote stability of aggregate prices. In a money economy, in which so much in the way of domestic and international trade depends on the stability of currency units, and so much in the way of long-term investment becomes gambling instead of risk-taking and so much of long-term saving becomes a farce without such stability, I do not see how we can be asked to accept and condone the speculative attractions of continuous inflation whether creeping, loping, or galloping.

That does leave hanging, of course, the question of the inability of general monetary policy effectively to reach through a complex of economic forces so as to help regulate the cost-push influences in the economy, or to apply selective restraint or stimulation to sectors of the economy which are in boom or in recession. I think monetary policy can make some contribution toward smoothing out economic fluctuations arising from non-monetary influences, but central bankers should be the first to admit, and to repeat in and out of season, that monetary policy can't do everything, and that selective monetary controls have severe limitations of acceptance as well as of administration. We, in the United States, and our mutual friends in the United Kingdom and in other advanced industrial countries, are groping for solutions of the disturbing effects of cost-price influences upon our economics. How to mesh increases in costs and prices, with profits and productivity, while asserting

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a national or public interest in the behaviour of prices has become a critical economic problem of our time. The fundamental solution is being sought and, I think, must be sought in the collective bargaining area which now sets the scene for so much that happens to costs and prices. General monetary policy, by itself, cannot effectively reach through to this area without bringing about such variations in prices and production and employment as are no longer socially or politically tolerable nor economically desirable.

We have made some attempts to meet a variant of this sort of problem, involving the limits of effectiveness of general monetary controls, by experiments with selective credit controls applied to stock market credit, consumer credit and mortgage credit. We have had a mixed success or a mixed failure, whichever way you want to look at it. The only one of these selective controls still being exercised is the fixing of margin requirements on loans secured by securities, traded on national securities exchanges. This regulation seems to satisfy some public sense of what is right and proper, and has enough loopholes in it to make it palatable without completely depriving it of effectiveness. It has kept a certain amount of credit out of the stock market and, to that extent, modified the repercussions of fluctuations in that market. I would say it is of peripheral importance.

Our experience with consumer credit control and mortgage credit control was more difficult -- the powers have been withdrawn by public demand -- but I

...ral or public interest in the behavior of prices, become a critical economic problem of our time. The fundamental solution of our present age, I think, must be sought in the policies and administering areas which now sets the scene for actions that determine costs and prices. General monetary policy, by itself, cannot selectively reach through to this area without bringing about such restrictions in output and production and employment as are no longer socially or politically tolerable nor economically desirable.

We have also had experience with a variety of this sort of problem involving the limits of effectiveness of general monetary controls, by experiments with selective credit controls applied to stock market credit, consumer credit and mortgage credit. We have had a mixed success on all of these, which, every way you weigh it, has led to [illegible] of these selective controls still being exercised in the fixing of margin requirements on loans secured by or purchasing, based on national securities exchanges. This selectivity seems to satisfy some public sense of what is fair and proper, and has enough flexibility to it [illegible] relatively without completely destroying the effectiveness. It has been a [illegible] the black market and, to that extent, [illegible] the requirements of fluctuation [illegible]. I would say it is of marginal importance.

Credit control [illegible]

would say they hold promise of making a contribution to economic stability. The mortgage credit market and the consumer credit market are broad and important segments of the total credit economy. Their homogeneity is such that it is possible to devise impersonal methods of regulation which are reasonably enforceable. It may be that this is a case of wanting just one more power, one more lever, to make the controls work, but I would say that the general powers of the monetary authorities could be supplemented by standby powers of selective control in these areas. Their potential for contributing to economic instability is substantial. There are times when their excessive demands for credit can create serious distortions in the financial sector of the economy.

In my opening paragraphs, and subsequently, I have made reference to monetary policy running in harness with other governmental economic policies, particularly in the area of taxation and management of the public debt, if the best results are to be obtained in regulating the financial sector. This is the question of the need for and the means of co-ordinating monetary policy with other government policies and, collaterally, it embraces the question of the appropriate relation between the central bank and the government -- the so-called "independence" of the central bank.

The need for co-ordination of fiscal policy, debt management and monetary policy seems to me to be so clear as to require little elaboration. On the negative side, and looked at from the point of view of the

insofar as they hold promise of making a contribution to economic stability. The mortgage credit market and the consumer credit as well are broad and important segments of the total credit economy. Their homogeneity is such that it is possible to devise [illegible] methods of regulation which are reasonably enforceable. It may be that this is a case of [illegible] [illegible] one more [illegible], the more [illegible], [illegible] the [illegible] [illegible] [illegible], [illegible] I would say that the general powers of the monetary authorities could be supplemented by standby powers of selective control in these areas. Their potential for contributing to economic stability is substantial. There are times when [illegible] excessive demands for credit can create serious distortions in the financial sector of the economy.

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The need for coordination of fiscal policy, debt management and monetary policy [illegible] to be so clear as to require little discussion. On the other side, [illegible] looked at from the point of view of [illegible]

central bank (disregarding international complications for the moment) if in a period of high and rising economic activity, government fiscal policy is expansionary -- reduced taxes or increased government spending or subsidies even where the economy is strong -- and if debt management seeks to finance government needs at low and credit supported rates with the most liquid kind of government obligations, the monetary restraint which would be indicated becomes less than effective and, eventually, impossible. To meet all of the credit demands which would be present in such a situation would lead to effective demand outrunning available supply, with an inflationary price rise as the result. And the encouragement which this would give to monetary speculation and to expansion of plant and equipment would exaggerate the inevitable cyclical swings in business in our kind of economy.

On the positive side, both under conditions which would require a restrictive policy and under conditions which would require an expansive policy, the fiscal authorities and the monetary authorities can be most effective only as they work together. If the situation is such that the total supply of credit and the rate of expenditure for output should be restrained, a restrictive monetary policy needs the support of a government fiscal policy which yields a surplus in the budget, so as to make the government a net saver rather than a net borrower and so as to reduce private spending. And, in resisting a downswing in the economy, the force of monetary action tends to become weaker as the down-

central bank (disregarding international considerations for the moment) if in a period of high and rising economic activity, government fiscal policy is expansionary -- reduced rates of taxes and government spending or subsidies even where the economy is strong -- and if debt management seeks to finance government needs at low and credit supported rates with the most liquid kind of government obligations, the monetary restraint which would be indicated becomes less than effective and, eventually, impossible. To meet all of the credit demands which would be present in such a situation would lead to effective demand outrunning available supply, with an inflationary price rise as the result, and the encouragement which this would give to monetary speculation and to expansion of plant and equipment would exaggerate the inevitable eventual swings in business in our kind of economy.

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swing persists and, perhaps, begins to feed on itself. The monetary authorities should keep money cheap and easy so as to provide the backing for whatever deficit spending may be undertaken by public bodies, so that government borrowing does not hold up the cost and decrease the availability of credit for private borrowing and spending. If a serious and cumulative depression develops, the main burden of combatting it comes to rest on fiscal policy. That is the reason for recurring proposals in the United States for executive authority to cut taxes in such circumstances, so that the fiscal remedy may be applied with speed and flexibility. Here again debt management, while playing a relatively minor role, should accommodate itself to the demands of the whole program, without adhering too rigidly to the ordinary requirements of low cost and staggered maturities.

The obvious need for co-ordination of fiscal and monetary policies and debt management with the general deconomic policies of government, and the increased participation of government in economic affairs, have forcibly brought into question the old concept of the "independence" of central banks. So far as we are concerned, the old concept lost its old meaning quite a while ago, and the legislative seal was placed in its demise by the Employment Act of 1946. The Federal Reserve System and price stability are not specifically mentioned in that Act, which gives expression to our present general ideas of the economic role of government, but they should be because our

owing persists and, perhaps, may in fact feed on itself.
[illegible]
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economic directive is incomplete without such mention. As I have said, in other places, the independence of the central bank is now independence within the government; not independence of the government. It is the independence of a statutory body with statutory responsibilities, which has the right and the duty to present its views forcibly within the councils of government -- in our case in consultation with the President and his Council of Economic Advisors, with the senior officials of the Treasury Department, and before the appropriate committees of Congress. It is independence of narrow partisan political bias. It is independence which is not subservient to a particular political party, but which serves the party in power while preserving the right of resignation of its principal officers without disloyalty to party if a clash of views develops which cannot be resolved. It is not independence to pursue a monetary policy which is in opposition to the general economic policies of the government. That would be intolerable and impossible. It is not the kind of independence which can be precisely bounded by a legal definition, any more than the honesty and integrity of men in government or private service can be legally presented. It is the kind of independence I should think would serve you well in Canada.

The subsidiary question involved in the above relationship between monetary policy and debt management has invited the suggestion that these functions should be administered by a single head or

by a co-ordinating committee. Quite aside from the general question of independence, my opinion is that this would be a mistake, whether the end result was the setting up of a single head for these affairs or the establishment of a council, with representatives from the constitutional bodies, which would make policy and direct operations. It is a case of what might appear to be logical on an organization chart, with precisely drawn lines of authority, becoming illogical in terms of evolutionary processes and human relations. The problems and operations of debt management and of monetary policy are so dissimilar, despite the overlapping of their spheres of influence, as to require more than one approach to their analysis, their synthesis, and their administration. What is needed is a clear recognition of their joint and separate responsibilities by men who bear allegiance to the same general economic policy of government, and regular means of consultation and co-ordination of policies and programs. Making the director of one the director of both, or putting the joint problems in the hands of a committee, would not solve personality conflicts but would weaken professional performance.

Turning to the problem of international balance, we have recently had striking examples in my country and yours, of the necessity of finding an appropriate and effective middle way between the demands of the domestic economy on monetary policy and the requirements of the international balance of payments. This is a dilemma which only awaited the

revival of the industrial capacity and competitive strength of Western Europe and Japan, the re-establishment of convertible currencies in the principal trading countries of the world, and restored freedom of movement of goods, services, and capital across borders, to become apparent in places where it had been forgotten or could be ignored. Like the more purely domestic problems with which monetary policy is faced, this one can be dealt with more easily if it is anticipated and attacked in its early stages. Then it is more likely than later that the policies appropriate to the domestic economy will also be satisfactory with respect to the balance of payments. If the situation is allowed to deteriorate, however, more and more attention must be paid to the international position and, if a crisis develops, it clearly must take temporary precedence over all but the most acute domestic concerns.

It is a problem which, I think, is peculiarly susceptible to probing adjustments to different combinations of circumstances and to varying mixes of fiscal and monetary policy. In the United States, at the end of 1960 and the beginning of 1961, we had to cope with a domestic situation which needed the stimulus of an easy money policy and an international balance of payments which was showing a serious deficit for the third successive year, a rising volume of short-term dollar liabilities and a gold stock which, while still adequate, had shrunk appreciably. Since we had a heavily favourable balance of trade in goods and

of the industrial capacity and competitive strength of Western Europe and Japan, the re-establishment of convertible currencies in the principal trading countries of the world, and increased freedom of movement of goods, services, and capital across borders, to balance appeared in places where it had been forgotten or could be ignored. Like the more purely domestic problems with which monetary policy is faced, this one can be dealt with more easily if it is anticipated and attacked in the early stages. Then it is more likely than later that the policies appropriate to the domestic economy will also be satisfactory with respect to the balance of payments. If the situation is allowed to deteriorate, however, more and more attention must be paid to the international position and, if a crisis develops, it clearly must take temporary precedence over all but the most acute forms of recession.

It is a process which, I think, is sufficiently susceptible to gradual adjustment to different combinations of circumstances and to varying mixes of fiscal and monetary policy. In the United States, at the end of 1960 and the beginning of 1961, we had to cope with a domestic recession which [illegible] the stimulus of an easy money policy and an international balance of payments which was already a serious deficit for the third successive year, a rising volume of short-term dollar liabilities and a gold stock which, while still adequate, had shrunk considerably. There was no [illegible] favorable balance of [illegible] in [illegible] goods and

services, it was apparent that in so far as any one category of the balance of payments can be adjusted, without adjustment of the whole, our difficulties arose largely from an outflow of capital on government and private account, and a particular danger lay in the area of volatile movements of short term funds. This suggested a policy which combined special steps to reduce the outflow of capital on government account, a monetary and debt management policy consistent with the domestic situation but with an interest rate structure tilted up at the short end, and a policy of budget balance for psychological reasons so far as the international position was concerned.

That policy, along with the various international arrangements which have been devised for dealing with temporary international imbalance, has had considerable success during the past year and three-quarters, but time may be running out. Because of a lagging economy which has not generated the revenue, anticipated in budget estimates, we are backing into a substantial budget deficit in the present fiscal year and easy money, by itself, at this stage of our business cycle, no longer provides an obvious upward thrust to the economy. I would be disposed to change the mix of monetary and fiscal policy while we still have plenty of time for manoeuvre. This would involve permitting interest rates to rise to more competitive levels, both at short and long term, thus giving additional evidence of ur purpose to defend the dollar, and offsetting whatever dampening effect this might have

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on the domestic economy by reducing industrial and corporate income taxes. This would convert an unplanned budget deficit into a larger but planned budget deficit, which should then be financed as far as possible out of savings. I would hope that, if the domestic and international positions remain much as they now are, this would be the outcome of the tax reduction we have been promised for early in 1963. This may be a pretty fine bit of balancing of pluses and minuses, but I would say that it would be a better "mix" than what we now have.

The place of "near money" and "near banks" in the whole scheme of monetary management, and the question of the money supply as a gauge of monetary policy as against the liquidity of the economy, has had a run of academic discussion and government consideration, highlighted by the advocacy of the liquidity concept in the report of the Committee on the Working of the Monetary System in the United Kingdom (The Radcliffe Report). It seems to me that in seeking to propound a new or revised theory of monetary management, these advocates have strained to exalt the virtues of liquidity control and to magnify the defects of control of the money supply and the related creation of bank credit. My own view is that there is a middle ground which retains primary reliance on regulating the money supply and the related creation of bank credit, but which also pays due and necessary attention to the liquidity of the economy.

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think I do, by remembering always that it is only the commercial banking system, working from a reserve base controlled by the central bank, which can "create" money in the sense of writing up demand deposits as the other side of a loan or investment transaction. Policies for influencing liquidity, as has been said and as I believe, must start from and be elaborations upon a policy with respect to money itself.

Viewed from this approach, the total supply of liquidity assets in the market and fluctuations in that supply may be said to depend upon (1) increases or decreases in the money supply, (2) the flow of savings out of current income and (3) the net movement of funds out of or into idle balances - the velocity of money factor. Among these three, it is the money supply which is most closely responsive to actions taken by the monetary authority, and it is by regulating the money supply that the authorities can attempt to compensate for undesired changes in the other two sources of liquidity.

Here the velocity of money is most important for the purposes of monetary policy and for bringing the concept of liquidity into a rounded view of monetary policy. It is a matter of common observance that the velocity of money - the rate of expenditure for output relative to the stock of money - generally rises during periods of economic expansion and declines during periods of economic contraction. It is in these broad cyclical phases that actual changes in employment, and income, and shifts in expectations on the part of consumers and

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businessmen lead to the activating of idle balances and the economizing of money relative to expenditures, or the reverse. The extent of these movements in the velocity of money, and the duration of the lag which they will introduce so far as the effect of changes in the money supply are concerned, cannot be predicted with accuracy, but that does not mean that regulation of the money supply is without effect.

The supply of assets which principally provide this element of liquidity in the economy (aside from money itself) are short term government paper (saving bonds are a special case) and, the market instruments issued by commercial paper houses, finance companies, and acceptors. The claims created and issued by financial intermediaries - mutual savings banks, savings and loan associations, credit unions, life insurance companies, trust funds, pension funds, etc. - are a secondary source of liquidity instruments and, even in this constellation, the role of claims issued by "near bank" financial institutions can be exaggerated.

In relation to the money supply, the offerings of short term Treasury paper are a matter of co-ordination of debt management and monetary policy. The supply of liquidity instruments originated by business firms other than financial intermediaries is, at bottom, based on the participation of the commercial banking system in the intimate complex of dealers and brokers which buy and sell and establish markets in such instruments. The contribution of the so-called

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financial intermediaries to the variability of the velocity of money arises, primarily, from claims issued by savings banks, savings and loan associations, and credit unions. These are the only claims of "near banks" that really have the attributes of "near money" -- claims that involve little risk and can readily be shifted into money with little inconvenience. There is not much evidence that shifts out of idle balances into and out of claims on these institutions are much of a factor in the cyclical changes in the velocity of money and they appear to be only a secondary factor in the long term substitution of "near money" for money.

In assessing the claims of the money supply and the liquidity of the economy for the attention of the monetary authorities, the Radcliffe Report would have given a more balanced guide to those who may look to it for light and leading, if it had not tried to make such a basic theory case for liquidity, but had suggested that "the authorities should not only control the supply of money, but also seek more broadly to affect the liquidity of the economy." The monetary authorities should seek to affect the liquidity of the economy, not by trying to acquire a measure of control over financial intermediaries but by seeking better information and a better understanding of the whole range of influences which alter the liquidity of the economy over time and from time to time.

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hanging -- the question of the magnitude of the responses of the economy, and of different sectors of the economy, to policy actions of the monetary authorities, and the lags in reaction time. It is clear that monetary policy cannot provide such timely and precise controls of the rate of expenditure of the economy, which is to be matched against the supply of goods and services, as would be required for treading, at all times and under all circumstances, the narrow ledge between inflation and deflation, between maximum employment and production and stability of aggregate prices. Even in less ambitious terms, however, monetary policy is subject to the difficulties of foreseeing the magnitude of the effects which will flow from action, and the difficulties of allowing for lags in reaction.

Yet, it is of the essence of the act of monetary control that forecasts of economic developments must be made and estimates of economic reactions must be attempted. To wait for the event, is merely to forecast that existing policy is the right one until something has happened to prove that it is wrong. In the present state of our economic reporting and analysis such turning points only become apparent some time after the period when a change in monetary policy would have been most effective in warding off trouble.

Nor is it given to us to be able to foresee accurately and completely how a change in monetary poolicy will make its way through the economy. In the aggregate our safeguard is that, as I like to emphasize, monetary policy has the advantage of being

managing -- the question of the magnitude of the [illegible] resources of the economy, and of different sectors of the economy, to policy actions of the monetary authorities and the lags in reaction time. It is clear that monetary policy cannot provide such fine, and precise controls of the rate of expenditure in the economy, as [illegible] be matched against the supply of goods and services, as would be required for treading, at all times and under all circumstances, the narrow ridge between inflation and deflation, between maximum employment and [illegible] and stability of aggregate prices. Stated in such ambitious terms, however, monetary policy is subject to the difficulties of foreseeing the magnitude of the effects which will flow from action, and the difficulties of allowing for lags in reaction.

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able to probe and withdraw, to apply or relax pressence in varying degrees, so that action can be modified if the general results stray too far from those anticipated. If these results do not always lie with fairness on all sectors of the economy, we must admit that we cannot achieve such perfection in this or any other area of government participation in economic affairs. The attempt to attain a general good may impose hardships on some people, some of the time. The problem arises most often in the administration of monetary policy in periods of credit restraint. If action then had to wait until it was certain that such restraint would apply equally to everyone, all of the time, there would be no action.

The lags with which monetary policy has to contend are the recognition lag growing out of doubts abut forecasts of economic developments, and the operational lag which affects the rate at which policy changes impinge on the economy. There are even critics who claim that, because of these lags and the operational lag in particular, the effects of monetary policy are wholly unpredictable and likely to be perverse, and they go on to prove it by selecting their own statistics of past performance. The way to progress in a less than perfect world, however, would seem to me to be to improve our ability to forecast and to assess the results of our actions, by collecting better data on the current performance of the economy, processing it more quickly, analysing and interpreting it more wisely and adding to it more reliable information

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on future plans for government and private investment and consumer spending.

This listing of opinions leaves me with two or three collateral questions to complete my comments on topics which your chairman originally posed. First, I shall try to sketch my conception of the role of central bank directors as I have observed it in the United States. The board of directors of each regional Federal Reserve Bank is, as you know, made up of nine members, three of whom are appointed by the Board of Governors of the Federal Reserve System at Washington and six of whom are elected by the member banks of the Federal reserve district in which the bank is located. These directors include bankers, business men, farmers, professors, doctors, lawyers, and maybe Indian chiefs. They all come from outside the staff of the Bank; the president of the Bank is not a director, but this is a matter of only nominal importance. The full board of directors at the Federal Reserve Bank of New York met twice each month, and an executive committee composed of five members of the board (selected in rotation) met in the weeks intervening between board meetings.

Such an outside or part-time board of directors, in my opinion, has a double virtue. First, it injects into the conduct of the everyday affairs of a central bank the standards of efficiency and practical judgment that well chosen men can provide from a varied experience -- and that includes everything from judging the fitness of the staff to administer the complex operational

functions of the bank to the maintenance of its plant and equipment. This contributes to an operating performance which can protect the Bank from much of the criticism which ordinarily is levelled at institutions not prodded toward efficiency by the profit motive. Second, and more important, the existence of such a directorate keeps the central bank in touch with men who know, at first hand, some of the things which are going on in the economy, which never appear in the statistics or which appear only after a lapse of time; and it gives the men who serve as directors an insight into the problems and methods of monetary control which should enable them to interpret to the community the policies and objectives of the central bank. In a mixed economy of government and private enterprise, the maintenance of two-way open channels between government and the private community is of great importance, if unnecessary conflicts are to be avoided and the efforts of the two are to be combined into something greater than the sum of the parts. So it is with the central bank. It must draw economic intelligence from the market and it must be able through persons who have some responsibility to give guidance to the market.

There is a possible source of embarrassment in such arrangements which, in our case, has been largely overcome by our somewhat peculiar Federal banking system. The outside directors do not have advance knowledge of final decisions with respect to monetary policy. In this most delicate area the making of final decisions concerning the use

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of the principal weapons of monetary policy -- discount rate, open market operations, reserve requirements -- the co-ordinate discussion takes place in the Federal Open Market Committee (the seven members of the Board of Governors of the Federal Reserve System and five of the twelve presidents of Federal Reserve Banks who serve in rotation, except the president of the Federal Reserve Bank of New York who is a permanent member), and the final action is taken either by the Federal Open Market Committee in the case of open market operations or the Board of Governors in the case of the discount rate and reserve requirements. There are none but statutory full time members in these two bodies, and they are public officials and public servants in every real sense. And, in the case of the Federal Open Market Committee, which I consider the heart of the Federal Reserve System, a cardinal principle of central banking is observed, namely, that those who determine monetary policy should have continuous contact with actual economic processes and with people in the market place, as well as with the representatives of government at the political centre. The making of monetary policy is a government function, but it should not be made in seclusion with only statistics and computers as companions.

In speaking to the question of the role of central bank directors, I have also touched upon the question of the relation between the central bank and other money and capital market institutions and between the central bank and the general public. In our circum-

stances, right from the beginning of the Federal Reserve System, it has been the policy and the practice to make public the widest variety of information concerning the operations of the System at the earliest appropriate time, and to supplement this information with background reports and statistics and to follow up with speeches and statements which may illuminate policy. This attitude toward the public has grown and developed over the fifty years of our existence for two reasons, I think. First, it was recognized that in our political framework the exercise of the monetary authority, delegated by the Congress to the Federal Reserve System, could not be exercised in camera, if the System was to retain its powers and its being. Second, it was rightly decided that a central bank's authority grows out of building up the widest possible interest in and responsiveness to central bank actions.

Relations with persons and institutions in the money and capital markets must, of course, be closer and more continuous than relations with the wider public. These are the people and the institutions through which central bank policy flows into action. Here, the part-time directors have a role to play, since usually some of them will be associated directly or indirectly with some of the market institutions. The irregular but continuous personal contacts of officers of the bank, at senior levels, must comprise acquaintance with members of the commercial banking and investment banking communities, of the security exchanges, the insurance companies, the investment

trusts, the pension funds and the whole range of people who combine to make up the money and capital markets. Finally, we have found it of some assistance to have committees in being, such as a general committee representing all market interests and special committees representing such interests as the government security dealers and the foreign exchange market, which can be quickly called together for consultation and, at times, for action.

There is one thing we have tried in this area of market and public relations which has not had much success, in my opinion. That is so-called moral suasion; the attempt by public exhortation to obtain voluntary support of a course of action. The volunteers either do not come forward, or they come forward in a variety of ways which represent varying degrees of misunderstanding of what is required, and the whole thing usually proves to be inequitable in its influence and ineffective in its results.

The final question on my list relates to the role of properly functioning money and capital markets, and the criteria by which their performance can be judged. That is a tall order. I can only attempt a skimpy characterization. Viewed from the position of the central bank, the role of the markets is to provide the channels through which the policies of the central bank reach out into all parts of the economy. The markets can perform this essential function, of course, only because of their wider role of bringing together lenders and borrowers, savers and investors and enterprisers,

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and matching their needs and their resources, and establishing prices for capital funds and credit which take account of risk and liquidity and all of the features of multiple special transactions. It is in these markets that the structure of interest rates and the degree of non-price rationing of lendable funds, as well as the composite expectations of future developments are finally determined.

Such markets are seldom functioning properly unless they are evolving and accommodating themselves to new conditions or to old conditions in new ways. They must always be reaching out and finding every pool of available funds in the economy and every worthwhile need for funds, and bringing together the supply and the demand so that there is breadth of dealing, without discordant jerks in price or availability. Smoothness, adaptability and overall equitable allocation of the credit and capital resources of the community are the signs of acceptable performance.

In ending this statement, I would like to emphasize one most important lesson which I garnered from my years in central banking. It is that central bankers should never allow themselves to be trapped into announcing "rules of the game" or into adopting policies which seek to shift to the marketplace the inescapable responsibilities of the central bank.

"Rules of the game," which attempt to fix the relationship of the central bank with the markets in which it iperates, over time, tend to freeze action in the face of changing domestic and international economic

[illegible]

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relations, so that deviations from the rules first become the rule, and then, abandonment of the rules is forced upon the rulers. And "rules of the game" formulated by a central bank, in isolation from its responsibilities as a custodian of one part of an economic program of government, are a barrier to that proper co-ordination of policies which is essential. In fact, they are presumptuous; a form of independence that went out of date long ago.

Even more insidious is the temptation, in paying due respect to the virtues of the market place, to try to shift to the market determinations which should be made by the central bank. There are no wholly "free" money and capital markets so long as a central bank exists and does its job under modern conditions. There must be private markets -- unpegged markets -- the pulses of which can be taken in determining central bank policy, but the actions of the central bank, no matter how or in what section of the market they take place, will always be a major influence on the private market and a major factor in its expectations. The search by a central bank for some mechanical guide to automatic action, for some norm of behaviour, in order to avoid the risks of fallible human judgments, ends up as a form of self-deception.

The central bank should exert its influence on the cost and availability of capital and credit openly and directly, as circumstances may require, in whatever areas of the market it can reach. To do less is to abdicate a responsibility and to forfeit a power which has been granted for public use.

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Royal Commission on Banking and Finance

Canadian Retail Federation

Retail Merchants Association of Canada, Inc., And the Equitable Income Tax Foundation

Hearings held at

OTTAWA

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ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,
Ontario, on Friday,
September 28th, 1962.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

* Mr. Gordon L. Harrold
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Vice-Chancellor
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- - - - - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

* Absent

I N D E X

VOLUME 47

Ottawa, Ontario,
Friday,
September 28, 1962.

--- At 8.50 A.M. the hearing resumed.

SUBMISSION OF

CANADIAN RETAIL FEDERATION

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APPEARANCES

D. M. Woods	- President, Canadian Retail Federation; President, Gordon Mackay & Stores Ltd., and Walker's, Toronto.
W. V. Creaghan	- President and General Manager, J. D. Creaghan Co. Ltd., Moncton, N.B.
Mark Ely	- President, Ely Ltd., Toronto.
Professor J.A. Sawyer	- School of Business, University of Toronto, Toronto.
James Orme	- J. L. Orme & Sons, Ottawa.
F. R. Southmayd	- General Credit Manager, Simpson-Sears Ltd., Toronto.
W. J. Tate	- Vice-President and Assistant General Manager, Charles Ogilvy Ltd., Ottawa.
W. G. Upshall	- Manager, Accounts and Cash Offices, The T. Eaton Co. Limited, Toronto.

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THE CHAIRMAN: I shall call the meeting to order. This morning we have a submission from the Canadian Retail Federation. Mr. D. M. Woods, the president, I believe, will introduce the members of the delegation.

MR. WOODS: May I proceed?

The delegation representing the Canadian Retail Federation appears for questioning in connection with a brief which was forwarded in July. A word of explanation about the Canadian Retail Federation might be in order preparatory to introducing the members of the delegation. The Federation was formed in 1941 for the purpose of forming a body to co-operate with the Wartime Prices and Trade Board and other agencies of the federal government. It was felt then that some central retail agency should be available to speak effectively for this industry. The Federation consists of a number of direct members of medium and large-size retail firms. They are of all types and are located in all provinces. We have, in addition, a number of Association members, some 34 in number, and the Association members are eight of national nature, one is a provincial Association and 25 are municipal. Included in the direct membership are department stores, mail order houses, chains and independents of virtually every type. The total membership is represented by the Federation and the member associations, and therefore we feel it enables us to speak as an organization representative of our very large trade.

The main purpose of the Federation when initially founded was to act as a liaison organization between the retail trade and government, and this kind of work with government relations has formed the principal functions of the Federation since that time.

Our activities have largely been concentrated around work with the federal government, but some work has been done with provincial governments, and this has been increasingly so as more provincial legislation is enacted which affects the retail business. In addition to this the Federation is working on behalf of retailing in other fields in producing annual reports and statistical studies and operating results.

With that statement I should like to introduce the members of this delegation. On my right is Mr. W. V. Creaghan, president and general manager of J. D. Creaghan Co. Ltd. of Moncton, N.B.

Next is Mr. Mark Ely, president of Ely Ltd., Toronto, Ontario. Mr. Ely is the honourary treasurer of the Canadian Retail Federation. His group of stores are in men's apparel and clothing stores, and he has special interest in charge accounts, which is his special form of credit.

Next is Professor J. A. Sawyer, School of Business of the University of Toronto. Mr. Sawyer is consulting economist to the Canadian Retail Federation and he speaks for us in that capacity.

Next is Mr. James Orme of J. L. Orme & Sons

of Ottawa. Mr. Orme has served the furniture industry and is a director of the Canadian Furniture Dealers Association, which is one of the Federation's principal associations. As such Mr. Orme, we feel, can speak for the retail section which has a large credit content in its business, and one which represents a very large number of retailers across Canada.

Next is Mr. F. R. Southmayd, general credit manager, Simpsons-Sears Ltd., of Toronto. Mr. Southmayd has technical credit granting experience.

Mr. W. J. Tate is vice-president and assistant general manager of Charles Ogilvy Ltd. of Ottawa. Mr. Tate has special credit background, having been president of the National Credit Grantors Association.

Mr. W. G. Upshall is the manager of Accounts and Cash Offices, The T. Eaton Co. Limited, Toronto. He also has technical qualifications to speak on credit.

The Federation, in presenting this brief, feels that we have prepared a brief that is careful and objective and designed as a document to be helpful, constructive and useful to the Commission.

You will note that the brief does not ask for anything but it does suggest that a few things might not be done. We assume the members of the Commission have read the brief. Would you like the summary in the first few pages to be dealt with?

THE CHAIRMAN: The Commissioners, I understand, have all read the brief. It is not usually necessary to read the summary unless you have some particular desire to do so.

MR. WOODS: No. We have no opening statement to make other than to say the brief does deal in depth with an examination of consumer credit in the Canadian economy and particularly with the retail credit granting function. We believe it has dealt with the development and economic significance of consumer debt and as an outline of practice in the Retail Federation.

With these remarks the delegation would be ready to answer questions put to the members directly or through me. It is our feeling that the Commissioners might like to have individual and personal views of the members of the delegation as a helpful means of at least getting some special experience in consumer matters. A number of members, of course, are qualified to answer technical questions.

THE CHAIRMAN: Thank you very much. We shall commence with the questioning.

COMMISSIONER GIBSON: Mr. Chairman, if I might start out, I wonder if Mr. Woods could tell us a little more about the Canadian Retail Federation? It started in 1941. Was there an association of retailers prior to that?

MR. WOODS: I think not of the larger corporate retailers. There are several retail organizations, and the Retail Federation does not encompass all retail organizations.

COMMISSIONER GIBSON: It encompasses mostly the medium-size and larger ones, is that correct?

MR. WOODS: The direct membership is made up of large and medium-size corporate retailers. We

have a broad position of representation through the association members who band with the Federation, representing retailing where the interests of the large and smaller retailers correspond, and in this case we represent a very broad segment of retailers, both large and small.

COMMISSIONER GIBSON: We have a brief from the Retail Merchants Association of Canada.

MR. WOODS: Yes.

COMMISSIONER GIBSON: Was there once just the one organization?

MR. WOODS: The Retail Merchants Association of Çanada at one time was an associate member of the Canadian Retail Federation, but they saw fit to separate our ways and they are no longer part of the Canadian Retail Federation.

COMMISSIONER GIBSON: How many members would you have?

MR. WOODS: If we count the association members who are indirectly members I would think it runs into tens of thousands, and there are several hundred direct members ranging from the large department stores and chains down to minimum-size stores in small cities and large towns. I should think that generally our membership on a direct basis would not include any retailers doing an annual volume of retail business of less than a quarter million dollars.

COMMISSIONER GIBSON: I should like to ask you a few questions about the growth of consumer credit

and what you are looking forward to. This is an interesting brief and it is pretty well confined to one subject. You talk about the rapid growth which has occurred in consumer credit in the post-war period, particularly since 1951. What sort of expectations have you for the future? You refer to the fact that there is probably going to be quite a marked increase in family formations in the late 1960's and you expect this will give renewed interest to instalment selling in particular. Would you say a word or two about your expectations?

MR. WOODS: Perhaps Professor Sawyer would like to speak on this. You will recall that in the brief the point is made that the domestic establishment is an economic unit of which retail credit is the basic means of financing, and there are substantially four million such units throughout the country. The extent to which these units require credit depends somewhat on the maturity of the family unit, and the proportion of the family unit at an early stage of maturity will vary with the rate of family formations. The more young families there are, the greater likelihood of their requiring financing. Therefore, the extent of credit will probably vary with the rate of family formation. I wonder if Professor Sawyer would care to deal with this?

COMMISSIONER GIBSON: I was hoping you could give us an idea as to whether you expect the rate of consumer credit to go on increasing in the sixties at the rate it did in the fifties, or will it level off?

I should like to ask some questions about the family unit theory, and so on, later.

PROFESSOR SAWYER: We might look first at the increase in consumer credit in the early 1950's and the latter part of the forties and point out the unusual circumstances associated with that period, namely, to a large extent, the unavailability of consumer durable goods during the war period, with the result that when consumer durable goods did become available in the post-war period there were large expenditures on these by families of all sizes. In the early post-war period I think it is evident that much of this expenditure was financed from financial savings which had been accumulated during the war period, but as these liquid assets were used up I think more and more families turned to debt financing. At the same time we have, of course, a rather marked increase in some areas in the availability of credit to householders. Thus, there was a very sharp increase in consumer indebtedness in the early part of the fifties, which I think one should attribute largely to the war period and then to the subsequent period of economic expansion associated with the Korean war, and so forth.

I think we are unlikely to see sharp increases in the use of consumer credit similar to those of the fifties. In fact, I think if the proportion of the population, in terms of age of the families, the heads at different age groups, the number of children per family, and that sort of thing, were to remain

constant and one had no innovations in the marketing of consumer credit, no new institutions coming into the field, then one would tend to see a levelling out of consumer credit. That is to say, consumer credit outstanding would continue to grow as the incomes of the Canadian families grew, as the total number of families grew, but the relation between consumer credit outstanding on a per person basis might tend to become relatively stable.

I suggest further that with the increase in family formation that is likely to occur in the forthcoming years, resulting from the increase in births, both in the war period and post-war period, we are likely to see a substantial increase in the number of families being formed. This will generate a demand for housing and for the types of consumer durable goods, refrigerators, furniture, stoves, and so forth, which are associated with establishing a new household. This will result in some further increases in consumer credit outstanding and this would be related not so much to the present incomes of these newly-formed families but more to their expectations of future incomes or the expected life of the family.

I have not myself attempted to make any forecast of the amount of family formations we are likely to see in the next decade, but I would expect at least on the basis of these considerations to see some increase in consumer credit outstanding which would be related to the expected increase in the number of new families.

COMMISSIONER GIBSON: So you do not anticipate any sharp increase in the amount of consumer credit per family unit except to the degree there are more new families coming into the picture. Is that a fair statement?

PROFESSOR SAWYER: Yes, I think so. I do not at the moment foresee that the use of credit by families would be much more greatly extended than it is at the present time. We have certainly seen a wide-spread increase in the use of credit over the last decade, not only for the purchase of consumer durables, which I have mentioned, but many other types of purchases. I am not an expert in the field of financial institutions but it is just my feeling as a general economist that unless there are some unforeseen developments here in new techniques or new institutions, for making credit available, then one would not expect to see in the next decade increases of the type we saw in the fifties.

COMMISSIONER GIBSON: You give the impression that there has been a big increase in the use of consumer credit, and now there is perhaps more stability and this leads to the general statement that is made in your memorandum that there is no cause for alarm about this picture provided a proper ratio of debt to future earning power, that is future earning power in the family, is maintained, and also provided that estimated future earnings are realized. Now, what do you mean by proper ratio of debt for future earning power?

PROFESSOR SAWYER: This must be something

that is looked at at the individual family level. When a family increases debt it takes on a commitment to repay from future income. It has to meet the cost of repaying the credit accommodation and in most cases the repayment of the debt and the cost of credit accommodation must come out of its future earning power. As long as it does not commit itself to indebtedness which its future earnings cannot support, then I would say there is not an improper relation between the two. I do not think I am in a position, sir, to express this in terms of any ratio.

COMMISSIONER GIBSON: You do use this as a sort of basic principle here.

PROFESSOR SAWYER: Yes.

COMMISSIONER GIBSON: And one of the interesting things is that the ratio of debt to future earning power, consumer debt, has increased in the post-war period. I take it you do not regard that with alarm. You feel this is a reasonable increase. Is that correct?

PROFESSOR SAWYER: For most families I think it has been a reasonable increase. We are talking here in generalities and not in terms of specific, individual cases.

COMMISSIONER GIBSON: Yes.

PROFESSOR SAWYER: I should not think there has been any evidence that families have committed themselves, generally speaking, to repayment of debt and charges associated with debt which they could not support out of their future income stream, provided the future incomes are realized.

COMMISSIONER GIBSON: When you say "proper" you must have some ideas in your mind about it or are you just rationalizing what happens rather than having certain standards in your mind? In other words, do the people that grant credit have certain ideas in their heads as to what is proper or do they think that the people who borrow the money will have ideas in their heads as to what is a reasonable ratio? I should like to get something more concrete on that.

PROFESSOR SAWYER: I would only speak from the viewpoint of the consumer and not of the credit institutions. I think other members of the delegation might speak on that side of the picture.

The point, I think, is premised on the assumption that the rational family, in its use of consumer credit, does make some attempt to draw up a household budget of expenditures and to include in its estimates of expenditures for future periods the amount necessary to repay the debt that is incurred, any charges associated with that, and still have a sufficient amount left over to meet its operating costs out of the income of the given period -- such things as the rent, the important payments and expenditures and so forth.

COMMISSIONER LEMAN: Would you keep your voice up, please, you are difficult to hear.

PROFESSOR SAWYER: I am sorry. I would suggest that possibly a detailed examination of the expenditure data from Canadian families which are collected by the Dominion Bureau of Statistics might be of assistance to many families, as an average for their comparable income group, number of children, and so forth, to give an indication of what an average household budget might look like, and this might be a considerable guide to families which are not in a position to work out the detailed arithmetic themselves. I have not, in my own work, pinned this down numerically, except to suppose there should be some relation between the two, but it would depend, in part, on matters of the preference of the household for, say, housing, as opposed to other types of goods, so that the rent component in their budget might vary, depending on whether they prefer

to have a little more room in housing accommodation or a later model automobile, or this sort of thing.

I think there is room for further research in this area, and I regret that we have not, as yet, been able to do this and quantify these relationships more.

COMMISSIONER GIBSON: Could some of the people who look after the trade end of the business say a word or two about the comparable aspects of income?

MR. WOODS: It is only a family unit with all forms of credit that are judged in one area. In the retail field the retail credit organization would not have views on credit granted to the household through other channels.

If you wish to explore this now you might be interested in the way that credit is granted at the retail stores. Perhaps Mr. Southmayd would care to say a word on that.

MR. SOUTHMAYD: I think it would be true to say the credit standards are qualitative first and quantitative secondly. First, you have to decide in relation to character, stability and general circumstances, whether the party is worthy of credit at all; and then, secondly, the question is, how much can this family, or party, properly handle? It is true that this is related to projected income. I think, generally speaking, there is no question that as consumer credit has increased family-wise the total indebtedness has become the more important

factor in judging how much additional credit a family can properly handle. As you know, in anything like this there are some imperfect judgments made, but basically this would be it. You cannot set a percentage, I do not think.

COMMISSIONER GIBSON: No, but when your people are granting credit in connection with the sale, say, of a refrigerator, or whatever it might be, do they try to find out what the current total indebtedness is?

MR. SOUTHMAYD: Yes.

COMMISSIONER GIBSON: Are they usually reasonably successful in getting a picture of the means or family's position?

MR. SOUTHMAYD: There are facilities. The Credit Bureau and Retail Credit operate in this field. It is not perfect, but, generally speaking, you can get a good idea of the indebtedness and position of the family. Not only do you do this in the initial instance, but later on, if a large request for credit comes in on an existing account, it is the usual practice to check back on these sources of information again, and to try to bring the picture up to date, as it were.

COMMISSIONER GIBSON: When you are granting credit you are concerned with the amount of obligations the person concerned has to meet out of his monthly income, I take it?

MR. SOUTHMAYD: Yes, tied also to the general asset position, stability position, other

income coming into the family other than that of the chief wage earner. There are many factors in this, as you know, but basically income is the important factor when considering quantity of credit.

COMMISSIONER GIBSON: Do you have any rule of thumb and say, "Well, you have tied up more than a certain percentage of your income, and that is enough."?

MR. SOUTHMAYD: We do not have a definite rule. We do say no, as you know, in many cases, but there is no definite rule because the factors vary so greatly. There is a number of factors entering into the picture. The industry is an important factor sometimes -- the seasonal aspect. There are many factors to be considered in arriving at a decision.

MR. TATE: I would like to add one thing further to this, that in our view the individual establishes his own credit record by the manner in which he pays his accounts; and it is determined whether or not those people are living within their income. We can base our extension of credit also on the record that the person has established. This is of more importance, because we cannot determine all the factors that go to tell whether that person should or should not receive credit. But we can tell, with the records from the Bureau, that the individual has been able to handle whatever credit he has undertaken.

COMMISSIONER BROWN: Do you have any quantitative guide-post as an extension of that?

MR. TATE: No. We feel that a person, by

his record, has been able to handle it; and unless it were a sizeable amount we would not be enquiring into it.

MR. WOODS: I think what has happened in recent years is that there has been a substantial improvement in the ready flow of credit information through the establishment of credit bureaus in various municipalities. Many of our stores are in quite small towns and cities, and yet we have quite good facilities which, I believe I am correct in saying, were not available ten or fifteen years ago to provide an easy flow of credit and credit information. I think this has been a strong supplement to reasonable credit granting.

COMMISSIONER GIBSON: Another factor in the outlook for the use of consumer credit is the shift away from durable consumer goods towards services that you have been developing in the last few years, that is likely to go on developing as incomes tend to increase and more emphasis is placed on recreation, travel, education, and so on and so forth. Do you expect consumer credit to move over into this area to a substantial degree? This is not perhaps the right question to ask the retail federation.

PROFESSOR SAWYER: I am really not as familiar with the service area as I am with the goods area, but there is certainly this trend you have mentioned.

I think it is important to the sort of

things we are considering here to distinguish between the use of credit which is repaid over a substantial period of time, possibly one or two years, as opposed to simply the substitution of 30-day credit for cash payment, which may be, as far as the individual family goes, a shift in the time at which they pay.

COMMISSIONER GIBSON: I am referring to instalment credit.

PROFESSOR SAWYER: Yes, I thought perhaps you were. We have certainly seen an increase in the use of instalment credit for travel and transportation payments, and this sort of thing.

COMMISSIONER GIBSON: I am wondering how this affects you. It might make some of your risks a little less good than they otherwise would have been. You would agree this is quite a noticeable tendency.

PROFESSOR SAWYER: Yes, I think this has occurred in recent years. I was trying to think of other examples of services where the payment for the service is sufficiently large that a consumer would want to pay by instalments.

COMMISSIONER GIBSON: There is a lot of this done in the educational field -- more by bankers, I guess. There are a lot of plans coming out in this area now.

PROFESSOR SAWYER: Yes, I had not thought of that area. This might be a very likely case where an extension of credit could occur.

COMMISSIONER GIBSON: What about the changes within your industry? What effect have they on the

credit business as opposed to the cash business? You have this great rise of the super market, and now the discount store. Have these basic changes in the technology of the industry had a marked effect on credit and cash sales?

MR. WOODS: I think that as these new types of retailing have developed, historically starting with the department store, at the turn of the century, and the chain store and super market, they have all started off on the basis of offering limited service, and the cash policy seems to have been a very strong part of their operation. Then there have followed additional services, delivery, and so on. The department store started off at the turn of the century as a cash, one-price retail organization, but now they are offering wide facilities. The super markets do not seem to have offered credit yet. The discount stores are now offering credit and in many cases, though not universally yet, for this service a separate charge is made.

COMMISSIONER GIBSON: Is this in connection with only some of their items?

MR. WOODS: Yes, this must be both revolving type charge account credit for current purchases and I expect there is also available financing for longer periods for consumer capital goods. Possibly Mr. Orme might have some views on credit in the furniture field.

MR. ORME: There has been no change, I think. I believe the new type of stores will have to

give the same service and use the same tools as we use.

COMMISSIONER GIBSON: Isn't there this initial emphasis on pay cash and take away?

MR. ORME: Yes, they do start that way, and they find the public wants service, and they end up by giving it. I am only speaking personally, from what I have seen, but most discount operators have eventually got into a retail department store business, and there is not a spread in price between a well-run retail operator and a discount operator.

COMMISSIONER GIBSON: Do you think the discount operators will provide just about as much credit as the department stores?

MR. ORME: Yes, to get their share of the business they are going to have to.

MR. WOODS: That might depend on the mix of merchandise they sell. It is my impression that in the somewhat more mature discount stores their credit runs at something like 10 per cent of sales volume, and that is a good deal lower than many conventional department stores and even stores of our nature, where ours runs at about 20 per cent.

Perhaps Mr. Creaghan has views on the changing pattern of credit in the Maritimes?

MR. CREAGHAN: In the Maritimes we have not got discount stores yet, and we do notice a little credit going towards travel across country and trips to England, and so on.

Was that your question?

MR. WOODS: Mr. Gibson was asking if there was a switch in the use of credit away from the retail type of credit and into service credit, particularly education and travel.

MR. CREAGHAN: It is not noticeable in the Maritimes yet.

COMMISSIONER GIBSON: With regard to the credit that retailers have been extending, your statistics bring this out very clearly. The amount extended directly by retailers has grown less rapidly in the last decade than the amount extended by finance institutions -- finance companies and various other finance institutions. Would you care to comment on this, why this is so?

MR. WOODS: I am trying to clarify a view on this. The table on page 20 indicates the growth of department store credit, which has been fairly even throughout the period. The top line, number 1, indicates the millions of dollars increase or decrease in balance outstanding in department stores credit, and the figures vary from a low of 17 to a high of 63 between 1951 and 1961. The other principal source of credit for consumers is chartered bank loans; in that case there has been a much wider variation. Our assumption has been that along about 1958 the banks got into the personal loan business in a much more substantial fashion, and that shows a substantial increase in each of those last four years; whereas the department store credit progresses at what might be regarded as an

even rate, on probably the same technical basis, without any major change, unlike the banking system.

COMMISSIONER GIBSON: Your increase in instalment finance company credit over a period, on a proportionate basis, is about the same as the department stores, but it is very much greater than the increase in credit extended by other retail dealers. The percentage increases are greatest in the department stores, instalment finance companies and the chartered banks.

MR. ELY: Yes.

PROFESSOR SAWYER: With respect to other retail dealers -- and I think one of the other members of the delegation will have to supplement my remarks on this -- I think it should be pointed out that in some cases when one makes a purchase of goods from a retail store one may, instead of obtaining credit to finance that purchase from that store, enter into a separate contract with a finance company, or obtain a loan from a bank in order to finance the purchase. If what is included by the Dominion Bureau of Statistics here under "Other Retail Dealers" are types of dealers which are not large enough or which do not have the facilities to finance consumer credit, then even though their sales must have increased substantially over a period, the consumer credit outstanding associated with those additional sales would be reflected in the instalment companies' figures of outstanding credit or bank credit.

COMMISSIONER GIBSON: But why would it be particularly reflected in finance company credit rather than in the figures for the stores who extend their own credit?

MR.WOODS: Mr. Orme might be able to comment on this.

PROFESSOR SAWYER: Perhaps furniture is a good example.

MR. ORME: The small dealer has not enough capital, and he has to fall back on the finance company to carry his paper.

COMMISSIONER GIBSON: That would apply to the small retailers?

MR. ORME: Mostly, I think.

COMMISSIONER GIBSON: How about the credit granting business? Is this a profitable business? Your brief says that retailers extend credit in order to sell goods and get the business, but is there not another side to it as well? Is not the extension of credit a profitable part of the business?

MR. ORME: I do not know. It depends upon the individual store. If it is good and it knows what it is doing, then perhaps it may be profitable, but most small dealers really do not know what the costs of doing business are. They do not know about the cost of the money needed to accommodate the customer. If they added up all the costs they might decide not to be in the credit granting business. Small dealers like myself are always on the fence. We do not know whether we are doing the right thing or the wrong thing. Sometimes we think it would be better to turn it all over to the professionals, but we do not know.

COMMISSIONER GIBSON: If you turn it over

to the finance companies does not some profit accrue to you? There is a dealers' reserve arrangement?

MR. ORME: Yes.

COMMISSIONER GIBSON: Is this just as attractive as trying to borrow the money yourself?

MR. ORME: I could not answer that. I have not studied it.

MR. WOODS: I think, Mr. Chairman, that the profitability in credit banking is an awfully difficult thing to analyse. I do not know how we would assess the charges for, let us say, a charge account as opposed to a cash customer, and the billing costs. I do not know whether we would be able to assess in our business whether the amount of credit income derived from our revolving credit operations begins to pay or does not begin to pay for the direct costs, let alone leave a margin for profit.

COMMISSIONER GIBSON: How about instalment credit?

MR. UPSHALL: In instalment credit I think it is very difficult to know from the outset whether a profit is made or not because it is a very complex business to try to arrive at the cost of doing it. It depends upon how far you go. You have to establish the factors that go to make it up. I would not be prepared to say there is at all times a profit or a loss in the instalment business so far as a department store is concerned. I think it could go either way. You would attempt to do it without a loss, of course, because you want the increased sales, but I

could not make a statement on it.

COMMISSIONER GIBSON: If you do it yourself you might be a little more generous in your credit terms than a finance company would be?

MR. UPSHALL: That is possible.

COMMISSIONER GIBSON: Finance companies usually obtain some kind of a return on their investment?

COMMISSIONER BROWN: I gather that your association has not tried to make a study of this?

MR. WOODS: A study of the profitability of credit?

COMMISSIONER BROWN: Yes.

MR. WOODS: That is right, and I am not sure that it would be possible to do it. I do not know how the accounting processes might be conducted.

COMMISSIONER BROWN: Let me put it this way; you have not made a study of what those accounting problems might be so that you could get all of your members to use the same accounting system and thus determine whether they are making or losing money on their credit operations?

MR. WOODS: That is right. There are other factors in operating a retail organization that have a much greater significance in the field of profitability than the granting of credit, and the costs thereof. Gross profit and mark-up are much more important.

COMMISSIONER GIBSON: I do not think I have any more questions in this area, Mr. Chairman.

THE CHAIRMAN: I would like to ask you about

charge accounts. I suppose, to a large extent, charge accounts are simple accounts that arise when a customer goes into the store, makes a purchase and pays for it at the end of the month? Is that correct, or does this cover a wider field than that?

MR. ELY: With respect to our own company does that and I am sure this is true of other companies of our size and which use our general methods of doing business -- this is simply a habit which has grown up with us. People need accommodation for thirty days in the same way as they need it with respect to a club of which they are a member. It is a service we render and is in much the same category as the delivering of a parcel. Its cost is a very small part of the total cost of our operation.

THE CHAIRMAN: It is not a case of the customer being unable to pay for the goods he purchases? It is for his convenience ---

MR. ELY: No, if we felt that for a moment ---

THE CHAIRMAN: It is a convenience to the customer. Instead of having to pay cash for his purchase he settles by cheque at the end of the month?

MR. ELY: Yes. I am sorry for butting into your remarks, Mr. Chairman. But, if we felt that any proportion of our customers were using credit as we extended it in the way of a 30-day charge account because of an inability to pay on his part, I am sure we would have to change our methods of operation quite drastically. While we have no method of screening out or judging a man's character from his constant appearance in our

stores, this system of cost accounts has worked out quite satisfactorily and its cost forms a very small part of our total cost.

THE CHAIRMAN: I suppose the people who go to your stores are people who can afford to pay?

MR. ELY: No, that is not always so.

MR. WOODS: Mr. Ely is subjected to the same competitive conditions as the others.

THE CHAIRMAN: What I have in mind is that that item of charge accounts is really not a major factor in this development of consumer credit. The big development is in instalment credit which presupposes that the person has not the ability to pay for the goods he purchases at the end of the month.

MR. WOODS: That is right.

THE CHAIRMAN: That person must borrow in order to spread the cost over a period of time so that he may pay for his purchases out of future income?

MR. WOODS: Yes.

THE CHAIRMAN: And the increase in charge accounts from $268 million to $415 million in the ten year period is a 55 per cent increase, and that might not indicate any real growth in that area other than the natural growth of the business?

MR. WOODS: That is right.

THE CHAIRMAN: But the figures with respect to instalment credit indicates something quite different. The increase there is from $138 million to $591 million, which is an increase of 328 per cent.

MR. WOODS: Yes, but an interesting thing has

happened to charge accounts with the coming in of revolving credit. Most retail establishments have some form of revolving credit which involves a free 30-day account, and the establishment then makes a service charge at the end of the 30-day period. This system seems to have replaced the conventional charge accounts. Perhaps Mr. Southmayd might elaborate on this.

MR. SOUTHMAYD: We are not as directly involved in the charge account picture as Mr. Woods has indicated. We have an option type of account which provides 30-day facilities. I do not think I am as well qualified to speak on the particular charge account end of this as is someone who has had direct experience on it.

MR. UPSHALL: With respect to charge accounts you have an account which, in our case, is a 30-day convenience account. Statements go out each month and payments come in for the total of the account. We do not consider that an extension of credit. It is really a convenience, and there is no charge made for it. It is quite distinct from an account where the amount is spread by instalments over a period. We have both types of accounts.

MR. TATE: There is one thing I would like to interject here. I think part of that change in the last ten years is because of the fact that prior to 1950, say, charge accounts were used as all-purpose charge accounts, and they were not always paid at the end of the month. People took two, three, four or five

months to pay those accounts. We have now this pattern of revolving charge accounts which takes care of those people who are, in some degree, delinquent with respect to their 30-day accounts. This change was made merely to seek the customer's convenience. Customers were using their charge accounts in many cases in the same way as we are now making them use a revolving plan.

MR. UPSHALL: There is a plan which combines those two factors, in which you have a charge account which, if it is paid within 30 days, there is no charge made, but if the balance of the account is not paid within 30 days there is a charge made. That seems to be the trend today.

PROFESSOR SAWYER: I might point out that it has not been possible for the Dominion Bureau of Statistics to obtain separate statistical information with respect to charge accounts and revolving credit accounts. Table 8 is just a rough attempt to show the figures, but the two types of account are tending to merge and thus create statistical difficulties.

COMMISSIONER LEMAN: Apparently you have not figured out yet whether in general the retailer makes any money on the extension of credit of the instalment type. Some of your answers give me the impression that it is a competitive factor that has crept in, and which has not been gone into by retailers in a systematic way. The retailers have just got dragged into this. Is that about the feeling of the Federation about this matter? It is fairly diffi-

cult to figure out, but have some retailers, at times, felt that others were going too far in this direction, and were lowering the standards?

MR. WOODS: I suppose there is the lunatic fringe of credit granting where credit has been given out on a too liberal basis, where down payments have been too small and repayments have been over too long a period, or where the individual has not been capable of supporting credit. I do not know that the retail trade would feel that it has been dragged into a maelstrom of credit granting. I think you have viewed it as a competitive factor in procuring sales volume, and when looked at in that light, and if the costs thereof are kept to a minimum, the question of making a profit or not out of credit granting is not really important. It is like keeping your bill for light bulbs down a reasonable minimum. I suppose we lose money in the function of granting credit -- I do not know whether I have answered your question or not.

COMMISSIONER LEMAN: Partly, but I am not sure that there is an answer to my question.

MR. TATE: I think our primary purpose is to sell, and credit is only an extra service, and it has grown up out of competition over the years. We feel that extra services should pay for themselves. We are trying more and more to make extra services pay for themselves. I am thinking of extra services such as in the way of deliveries. These are things that are creeping in, and we are, because of competitive factors, seeking ways to make them pay for themselves. We do

not want to make a profit out of them, but we are interested in getting all of the volume of sales we can out of them, and seeing that the people who want special services pay for them.

COMMISSIONER LEMAN: What do you think the cost of the funds you invest in this particular area of business is when compared with the cost of the funds that the finance companies use for the same purpose? Do you think your costs would be higher, lower or about the same?

MR. TATE: I think we would be approximately the same. It would depend on the size of the retailer, and the rate that he can obtain. I do not think it would be fixed for all of them. I think in some cases it would be higher, and in the case of the larger retailer it would probably be similar to the cost of money to the finance companies.

COMMISSIONER LEMAN: In which case it would be reasonable to expect that you would make money on it?

MR. TATE: The larger ones could possibly make a profit but I would say that the smaller ones are likely losing on it. That is the narrowness of the margin.

COMMISSIONER BROWN: I have one or two questions to ask. Discount houses have been mentioned several times, and I notice in each case they have been referred to as "they", which would imply that they are not members of your association.

MR. WOODS: No, that is not quite correct, because there is a discount house member of the

association. This is a little fuzzy. It is a matter of terminology.

COMMISSIONER BROWN: Everybody referred to the discount houses as "they".

MR. WOODS: The discount phenomenon is a most interesting development. Perhaps I might be allowed to give my own view on this subject, which view may be contrary to that of, very large and very fine retailers. I really think the function discount houses perform has been a healthy one in many respects, and other retailers are taking leaves out of their book.

For example, there is the elimination of selling functions within the store. That is one of the essential characteristics of the discount venture. It is quite surprising to see the extent to which other retailers are following that practice. There then is the aspect that in their stores they put their merchandise on open display -- this is a large factor -- and they have adequate parking and a good amount of publicity and advertising. I would not like to say that there is no difference between a large department store and a discount store, because there is, but many of the essential characteristics of the discount store are appearing in conventional stores. Our own stores aredoing this increasingly. We have open displays, and we have well-informed sales people in which respect we probably are different from the discount store.

We are concerned about parking, and we are concerned about the promotional and advertising image that we pass on to the public. Many things that

are important to the discounter are also important to the conventional retailer. We are all serving the public.

COMMISSIONER BROWN: The second question I have to ask involves a matter of opinion. There was a discussion on the extension of credit in the service part of life such as travel, education and so forth. Is it your opinion that this is going to cut down on the amount of credit that is granted for the purchase of goods, or is it going to result in an overall increase in consumer credit?

MR. WOODS: I do not know. I wonder if Mr. Southmayd would care to comment on that. Perhaps I might interpose one thing. It may be that increased competition in the retail business, placing somewhat greater emphasis on improved values, might under the pressures that retailing is subjected to presently, make goods relatively more attractive than services. I do not suggest for a moment that services are going to drop off as a long term trend, but the values offered at retail, I think, are tending to improve. I am referring to the physical things that are sold in stores. This might tend to counterbalance a tendency, or a long term trend, towards an increase in the amount of money spent on services.

COMMISSIONER BROWN: It is important in the context of how far consumer credit is going to increase, and what is a proper level for it. Is this going to be at the top, or ---

PROFESSOR SAWYER: Perhaps I can make a comment

on that. I think in part we have to look at the characteristics of the family unit that may borrow for travel purposes, let us say, or education, as opposed to those who may borrow for the purpose of buying durable goods. It may be that families that are already well along in what we call the family life cycle -- that is to say, families whose children are grown up, or are through high school -- which are no longer under pressure to obtain larger houses or additional household appliances, or which may even have a tendency to move into a smaller house -- this sort of family that previously had been borrowing heavily for durable goods may now consider itself free to travel and will borrow for the purpose of travelling and seeing the world, or they will borrow money to see their children through university.

Whereas if the family is newly formed with no children, and so forth, it may be that they are borrowing for durable goods. If this assumption is correct, then the tendency to borrow for services may be in addition; that is to say, families which would otherwise not have borrowed, families that have reached the end of their borrowing and may not borrow for services. It is in addition to it. That is to say, from the overall point of view it would be an additional volume of consumer credit outstanding, but I think the crucial point is whether one looks within the individual families and says, "Is the individual family adding to the total amount of credit it has outstanding; is it substituting one for another?".

COMMISSIONER BROWN: You have no figures on this?

PROFESSOR SAWYER: I would suggest that possibly the surveys on liquid assets and indebtedness which the Dominion Bureau of Statistics have been carrying on for the last ten years or so might be of considerable help in obtaining further information in this area, but as far as I am aware none is available in Canada at the present time.

COMMISSIONER BROWN: Thank you.

COMMISSIONER GIBSON: Mr. Chairman, I would like to go on to examine a little the borrower and the economics of the household. This is a very interesting analogy, and it is rather nice to see the economic family calculating everything so precisely, and so on. I would like to ask you about some of the concepts here.

You make the statement that the household is under-capitalized. What does that mean, in relation to what?

PROFESSOR SAWYER: This, I am afraid, is really a suggestion and not a result of any direct evidence, but rather an inference from the behaviour observed in families over the past decade and, indeed, it is conceivable that the tense of the sentence should be the past instead of the present.

That is to say, we have witnessed a rather large addition, I think, since the end of the war to the stock of durable goods in the household sector of the economy, and the suggestion is that the households themselves felt that they didn't have the stock of capital equipment and the physical needs in the house itself, and what we are witnessing is a building up of the plant, if you like, or the house, and the equipment with which to operate it. But any statement as to whether a particular family or groups of families are under-capitalized is really a subjective evaluation that the family itself must make. All the economists can do is infer from the fact that families have continued to add to their stock of goods, and have been willing to pay the price for credit accommodation in order to do so, that they feel that the benefit of services that they obtain from this capital equipment is substantial and in this sense that they have somehow improved their position by adding this capital to their stock. But it is usually an inference on the assumption that in many cases, or in most cases, one should say, the family somehow rather roughly makes this calculation -- and very early

in our presentation we have used a model of a rational calculating family simply to illustrate the sort of things one might do -- but still most families probably make this rough sort of decision. They decide whether they want to spend now or whether they want to add to their stock of durable goods and consume services of these durables in the future and the mere fact that they have been adding to their stock of durable goods seems to suggest that they, in their own minds, thought that an increase in capital was desirable. I don't know whether this really answers your question, sir.

COMMISSIONER GIBSON: I can see your argument that they were under-capitalized after the war, because in relation to what was customary, and so on, they were short of these things. More recently one does things in relation to what you may have and what the other fellow does, but you are really rationalizing the past rather than saying that the household is under-capitalized with real capital now, is that correct?

PROFESSOR SAWYER: Yes, the statement was intended as an inference from past behaviour of the households, rather than a sort of an evaluation of the present state of the consumer sector.

MR. ELY: Would it be under-capitalized? Or a greater desire at certain times in the family life cycle when you are starting a home that there might be a certain element of keeping up with the Jonses or starting off with perhaps more than they absolutely require, and "desire" might be the word rather than "under-capitalized".

COMMISSIONER GIBSON: Yes.

PROFESSOR SAWYER: I think in part this comes back to this increase in family formation which we see for the future, and for this group of new families. Again this is the sort of behaviour which is being observed.

COMMISSIONER GIBSON: But you have built sort of the model here, and I would like to try out some of the other concepts. You say, for example, that the return on investment in durable goods is high. Now, from the calculations that you made, I suppose the charge is very high for renting, but what are your other charges when you make that statement?

PROFESSOR SAWYER: I am inferring again, and this is only an inference based on the fact that since the household has been willing to pay the price for credit accommodation, that the benefit that it receives from the goods that it has purchased on credit, in th own minds, is worth the cost of this credit accommodation.

I am not aware of any attempts that have been made at the individual level, and I think this would have to be done on some sort of a survey basis with individual families and really trying to evaluate whether the family has actually been rational in its decision to seek credit accommodation for this purpose. That is a very tricky thing to do. There is a limited area in which the family has the alternative of either renting or buying, and one can say then that by buying the goods they are avoiding paying rent for them, and equate the value of the services they

obtain from owning the goods with the rent they would otherwise pay for having them. One should take into account the price of credit accommodation and the cost of the capital goods to see whether this has really been a "profitable situation for the household".

One tends to get mixed up here with two things, which I think one might sort out. One can attempt to construct a little model which is useful for explaining this behaviour and for forecasting what may happen in the future to fairly large groups. The model may not explain the behaviour of any particular individual, but on the average it works very well as an explanatory device. On the other hand you can try to lay down some norms, or basis for rational behaviour, which the household should follow in order to do things. We have really more concern with the former; that is, an attempt to develop a model which explains the behaviour of the consumers.

COMMISSIONER GIBSON: I think it is a very interesting attempt, but frankly I have the feeling it is a rationalization of what has happened. For instance, you make the case that there probably isn't any misallocation of resources in the expansion of consumer credit because you assume that the consumer fully understands the cost of credit and is, in fact, making a productive investment with his eyes open, and is looking for other alternatives, and so on and so forth. This is the assumption, isn't it?

PROFESSOR SAWYER: There is the difficulty in many cases of the consumer not knowing the price of

credit accommodation to him, but in the cases where he knows this, we assume that the consumer is acting rationally. Indeed, in most cases the basic assumption of our society is that we do not question consumer behaviour; we assume that the consumer knows what he wants in most cases and proceeds to do the things which will maximize some sort of a subjective return, whatever it is, to him.

COMMISSIONER GIBSON: A consumer is the king, so to speak.

PROFESSOR SAWYER: Yes.

COMMISSIONER GIBSON: But it doesn't mean he is rational. I have heard the theory propounded that the reason people buy washing machines and refrigerators, and so on, is that they move into a certain group where the people around them have these things, and the wife wants these things, and the people at the plant have them and their friends have them, and it is conforming to the social pattern in which they live, and a lot of people hold the view that they don't make these calculations at all, they just sort of move along where they happen to be. I suppose your argument is that there is a sufficient margin, enough economic men and women to act on the fringes of these groups?

PROFESSOR SAWYER: I think in part this is it. This may account for some of the shifts in sources of consumer credit that we have seen over these periods. It only takes really a few calculating rational individuals to find out that there is possibly a cheaper way of obtaining something, and I am speaking very

generally here, before this news spreads very rapidly and everybody is doing it.

COMMISSIONER GIBSON: But a lot of people are emotional; they like to conform.

PROFESSOR SAWYER: If this is what they want to do it is rational behaviour on their part, isn't it? I am working on the premise that whatever he wants to do is really rational; I think I am defining my premise that way.

COMMISSIONER GIBSON: You are saying that they make precise economic calculations and weigh the alternatives, and this is the thing I am questioning.

PROFESSOR SAWYER: No, I am sorry, sir, I don't think we have really said that all families do this.

COMMISSIONER GIBSON: No, you admitted there are a lot of exceptions.

PROFESSOR SAWYER: Yes.

COMMISSIONER GIBSON: But you have suggested that this might be a sort of underlying direction, and it may be, I don't say it is not.

MR. WOODS: May I make a comment? This may be the broad scattered behaviour with an underlying trend, as you suggest. We have had experience with some of the people in our business who presumably have calculated rather unwisely and they have stubbed their toe on economic problems, so to solve this -- and one particular case that comes to my mind -- the individual has sold his motor car and he is re-drawing his budget within the limits that he can accommodate it.

Other people -- like myself, I can never be sure how much money I have in my pants' pocket -- but it varies all the way from a person like myself to somebody who has stubbed his toe to somebody else, who is also in our business, who does know precisely what he is spending on capital goods and relates that to his income and his anticipated income, and he has a very clear idea and he is making very rational decisions. The first one was not making very rational decisions, but having come up against a barrier, he is making rational decisions and is trying within his limits.

COMMISSIONER GIBSON: You constantly have people that are living out of the area that is reasonable and are getting into trouble and then looking at the facts of life.

MR. WOODS: This has happened to us in the last couple of months, and I think it is pertinent to the subject and within broad boundaries this must happen. Somebody gets into trouble and if they are well coached they can get out of it. They may over-step the reasonable boundaries.

THE CHAIRMAN: I am sure you are not suggesting more people get into trouble with more rational decisions?

MR. WOODS: No.

COMMISSIONER LEMAN: And you built a little model to prove that a family may be under-capitalized if it is not a two-car family! There must be people trying to do that in the States now?

MR. WOODS: A friend of mine was telling us about a friend of his who used to drive a very large car and it ate up gasoline at a fierce rate, and they recently acquired two modest-sized cars and they are now a two-car family and it is costing less to operate the two cars than it did before.

COMMISSIONER GIBSON: Those are all the questions I have, Mr. Chairman.

THE CHAIRMAN: We will adjourn now for 15 minutes.

--- Recess.

THE CHAIRMAN: We shall now resume.

MR. WOODS: Mr. Chairman, there may have been some doubt left in your minds as to this problem of the profitability or unprofitability of credit granting on the part of retailers. I think Mr. Southmayd might be able to comment on this and dispose of what may be an area of confusion in your minds.

MR. SOUTHMAYD: Mr. Chairman, there was possibly some wrong inference drawn from the answer given on this matter. Just to recap, I think the statement was made that credit is used as a tool of selling merchandise and that the large companies do not want to suffer a loss but to make a credit operation break evenly. There were no precise figures given on this but I think the fact is that the large companies within themselves have figures which satisfy them that the granting of credit on the basis they are doing it is satisfactory to them and a benefit from the merchandising veiwpoint. But you cannot generalize on this, for there is no agreement between companies as to the elements which should go into the costs of handling credit transactions. In this connection it might be interesting to know that in the United States the N.R.M.A. controllers and credit groups have been endeavouring to establish standards on which they could figure out the normal cost of doing credit business in an ordinary operation. They have not been able to get enough agreement on which elements should be included to come to any standard conclusion, but each individual

company on its own maintains sufficient statistical data to satisfy itself that it is not having a substantial loss on this. Does that answer the question?

COMMISSIONER BROWN: I am very pleased to have this answer, for I was getting a little despaired that the sophisticated retailer did not know the cost of his credit but he was making the assumption that the unsophisticated purchaser did.

MR. SOUTHMAYD: We were concerned that this was the impression given.

COMMISSIONER BROWN: I should like to move on to the question of the responsiveness of borrowers to credit conditions. A considerable part of this has already been dealt with. We have got the picture that the price of credit apparently does not change and, in the sense that the grantor of the credit does not really know what his cost is other than on this general basis which you have just enumerated, presumably he is not in a position to judge whether he should change his credit costs to the purchaser. My question is: Is there in fact a change of cost to the purchaser?

MR. WOODS: Depending on variations in the economic cycle?

COMMISSIONER BROWN: Yes. Is this based on your costs or on your availability of funds, or is even this not a factor?

MR. WOODS: I wonder if Professor Sawyer has any views on this in terms of the cycle, and perhaps

those technically involved in credit could answer the question.

PROFESSOR SAWYER: I think it would be better for the credit people to speak first. Would Mr. Upshall speak on the operation of consumer credit?

MR. UPSHALL: Are you asking the question, sir, is this based on an increase in the cost of money?

COMMISSIONER BROWN: I am merely asking the question: At any stage in the cycle do you vary the cost you charge the consumer?

MR. UPSHALL: Normally we do not. Are you asking whether we lower our costs to the consumer if we run into a depression, for instance?

COMMISSIONER BROWN: All right.

MR. UPSHALL: No, that is not normally done.

COMMISSIONER BROWN: Do you vary your credit terms, which is a way of lowering costs?

MR. UPSHALL: Not as a rule. I think the trade as a rule does not vary it in relation to the economic cycle.

MR. TATE: The cost to the consumer has been kept relatively on the same rates or same basis for a good many years. Competition is the thing that forces us to stay on these particular rates, so we do not look at our costs to the degree we might because we want to get the volume of business out of it.

COMMISSIONER BROWN: Does this tend at any stage to make credit easier to the consumer than it would otherwise be?

MR. TATE: The mere fact there has not been many changes is, I think, your answer to that. The only way we make credit easier is by bringing new forms of extension of credits, such as the revolving and continuous types, in order to suit the particular customers who were taking these things under the old 30-day accounts but they were not to a great degree being set aside in the same way.

MR. SOUTHMAYD: I think, sir, it might be fair to comment that in the long run there has been a relationship between increased costs generally and an increase in the price of credit. If you go back a number of years you will see that this is indicated . However, in the short-term the composite of the makeup of the cost of credit is such that in any particular business cycle the factors might not be of sufficient importance in the mixture of the factors to result in any significant move in the shorter term.

COMMISSIONER BROWN: This pretty well disposes of it. You have no measure of responsiveness because there are no changes.

COMMISSIONER GIBSON: What about advertising. Do you not increase your advertising at times when competition is pretty keen and it is difficult to get sales?

MR. SOUTHMAYD: I should like to answer

Commissioner Brown's question first, if I may. In the original instance the revolving charge or revolving credit back in the early stages was at a rate of possibly one per cent per month. The standard over the years generally has gone with increased costs and increased prices.

COMMISSIONER BROWN: What is it today?

MR. SOUTHMAYD: I think the average is around one and one-half per cent.

COMMISSIONER BROWN: One and one-half per cent per month?

MR. SOUTHMAYD: On the balance.

COMMISSIONER BROWN: Did this bring about any change in consumer demand? Was there a reluctance that was evident at all on the part of customers to this increase?

MR. TATE: Not generally, no.

MR. SOUTHMAYD: It was in line with other trends.

COMMISSIONER BROWN: Did this increase come about pretty well at the same time throughout the industry?

MR. TATE: No, it was well spread over. It went more in sections than it did across the whole industry.

COMMISSIONER BROWN: And the consumer was so unresponsive to this change that everybody moved up to this level?

MR. TATE: If all merchants in Ottawa, for instance, changed then there would not be any resistance

to it. If half of them changed and the other half did not, then there would be a certain amount of resistance to those who had changed.

COMMISSIONER BROWN: How did this unanimous change come about?

MR. TATE: It is not unanimous even yet.

MR. WOODS: Might I say what happened in our business, for outlining a specific case might help explain this point. We have had conventional charge accounts. We are not in hard goods. We are in consumer apparel and certain domestic lines, and we have had a conventional series of charge accounts in our 38 stores for a number of years. We wanted to extend that service so we now have a revolving credit system installed. This was only completed in our stores in the past three or four months. We began experimenting with it a year and a half ago and we sought advice from the N.R.M.A. and from substantial retailers in Canada as to how it should be done and I think we came up with something unique. It seems to serve our purpose and it is the kind of credit we are prepared to give. It has a fixed amount of repayment per month. There is an automatic amount of $80 for credit and a fixed amount of $10 for repayment per month. Therefore, the account can be extended for a period of eight months. For that service we make a dollar charge, which in the case of our Walker stores amounts to a service charge of $1.30 per month if the amount is $80 to $90. This service charge of $1.30 is added at the monthly

period to the account. This has been received very well indeed by consumers, and we have had people tell us they are very glad to have this kind of facility available which previously had been available only from larger retailers in the larger communities. In terms of timing and type of credit this has come along through our development. We were concerned about various things our company should do to develop its future, including such matters as adding new stores, modernizing old stores, adding additional types of merchandise, devising new merchandising record systems which would make our operation more efficient. We wanted to develop our credit business, and in the over-all scheme of things the development of credit is a fairly minor matter, for I think we are likely to improve our business more by other devices. However, one of the tools in developing our business is undoubtedly the development of our credit system which has been devised with the help of others but which I think is unique. In terms of timing it has not come along all at one time and in our case it has just been completed in the last several months.

COMMISSIONER BROWN: In other words, this is a responsiveness to a service?

MR. WOODS: In terms of developing the cost we have had quite a remarkable acceptance from our customers for this form of credit and with respect to the charges made for it. I think it is something we have contributed to the communities where we

operate. It is something which in many cases we did not have before for our credit merchandise. We feel that the cost is competitive with the best practices in the industry, drawing on expericne both in the United States and in this country.

COMMISSIONER BROWN: If the borrower has not been responsive to any changes because there have not been any real changes that he has been capable of measuring, has there been a pattern with respect to his use of credit? I mean, has a demand for credit from the borrower varied on a cyclical basis?

PROFESSOR SAWYER: Yes. I think the data we have indicates there is a bit of a time lag. That is to say, when a slow-down in the rate of increase in Gross National Product occurs this gradually has its effect on the spending habits of families and shows up with a bit of a cut-back in consumer credit, and again when the pace of economic activity speeds up you can see a bit of a time lag. It seems to me on the basis of what we have heard so far that this is more related to the effect of the business cycle on the income and employment opportunities of the borrower than, say, on the cost of credit accommodation.

COMMISSIONER BROWN: Has this variance been the same or greater than the cash sales of the same type of goods?

MR. TATE: No. My feeling is that there is relatively little change in the percentage of total over a period of time. It has remained fairly constant with little fluctuation. I think the question

you raised was whether there was a greater demand for credit in relation to total sales, and my answer is no. There are little fluctuations over quite a long period of time in percentages of credit sales to total sales.

COMMISSIONER GIBSON: Thinking of the response of the retailer himself, are there other factors than varying the cost of credit you may add? Does advertising of credit facilities and credit terms vary with changes in general economic conditions? Are you a little more finicky after you have had a big increase in growth and when perhaps you are getting more difficult accounts? Do the terms change from time to time?

MR. WOODS: I think, sir, probably the credit grantors are a little more careful if they are running into difficulty in payments. Certainly they watch new purchasers in that area. That is a small area of the total group, buying on credit, but I agree with your comment. We probably are a little more restrictive as to what you would call a good credit risk.

COMMISSIONER GIBSON: At a time like 1956 when money was again tight and the banks were in a position where they had to ration credit a bit, would this be regarded as a signal to tighten up on your credit terms a bit?

MR. WOODS: Not on the terms so much as on the granting of credit.

COMMISSIONER GIBSON: That is what I mean,

your selection of risks. I think you do tighten up and are more strict. That applies pretty generally.

COMMISSIONER BROWN: Then there are two elements in this. One is that under such circumstances there is a lower demand for such credit because there is also a lower sales volume anyway, and in addition there is a lower supply because you are a little more reluctant to grant the credit.

MR. TATE: I think so.

MR. SOUTHMAYD: There is a third element that works against this. When over-time is being reduced and incomes are being reduced there are more good credit risks coming back into the market. Some people who in the high point of the cycle might not wish to use credit but have good credit backing or are eligible for credit come back into the picture, and this is an offsetting factor against these other things you have talked about. It tends to level out the total demand.

COMMISSIONER GIBSON: Do you tend to increase your advertising at times like this so that you can get a bigger selection in order to get more good risks?

MR. WOODS: May I comment on that? I would think historically it does not seem to be that the proportion of the dollar sales volume devoted to advertising increases in times of business depression. There seems to be a tendency to relate costs to the volume of sales anticipated, and we attempt to maintain a percentage of our sales in our advertising budget.

In terms of advertising credit I think we are presently doing a bit more advertising of credit because of this new plan we have established. But our advertising in general, I should think, would tend to conform to the operation in our sales levels.

COMMISSIONER GIBSON: I was thinking of advertising credit and credit facilities.

MR. TATE: I think your premise is quite right. Sales is the first consideration. I think you are on the right track, that when sales are going down we will certainly take another look at the factor of whether we can advertise slightly longer terms, whether it would give us additional business or whether we should change our form of credit in order to get back part of the volume of business that is going. Your premise there is correct.

COMMISSIONER BROWN: You make quite a point of the fact that monetary policy has relatively little effect or no effect on consumer credit, and you go further and say that it is wrong that it should. However, if I read these inferences in this brief correctly, you feel consumer credit should be left untouched.

PROFESSOR SAWYER: What we are saying is that consumer credit should not be singled out for special attention, but the general tenor of one of the latter sections here is an indication that it is possibly some of the imperfections in the credit market that have contributed to this lack of sensitivity and that possibly the removal of some of these might

make the consumer credit market slightly more sensitive to changes in general monetary conditions. I was not aware there was anything in here that argued against consumer credit being sensitive to general changes, changes in the monetary policy such as a change in interest rates or so forth, which were designed to affect all sectors of the economy. These should work through the price system and have whatever effect they might.

COMMISSIONER BROWN: But apparently they have no effect on consumer credit.

PROFESSOR SAWYER: Apparently they have not had in the past. Some of the reasons for this have been pointed out. I am not as familiar with the various sources of financing, and so forth, as others here but we know, for example, that the rate of interest of bank loans does not fluctuate very substantially in business, and this may be only a small component of the total cost of granting credit to a retailer, and that by the time this is transmitted there is in effect a dampening down and a disappearance. It takes rather wide movements in general interest rates to have any effect on particular sectors of the economy. We do suggest it may be rather undesirable for the economy generally to undergo these wide fluctuations in interest rates but not because they have any particular effect for the consumer sector as opposed to the business sector and government financing.

COMMISSIONER BROWN: Is it not a fact that the extent to which monetary policy influences business

decisions has not been sufficient to affect consumer credit?

PROFESSOR SAWYER: This is a statement of past fact.

COMMISSIONER BROWN: That is right. Then you go on to argue against specific controls for consumer credit.

PROFESSOR SAWYER: Against specific controls?

COMMISSIONER BROWN: Yes.

PROFESSOR SAWYER: Yes, I think we must distinguish very clearly here.

COMMISSIONER BROWN: What I want from you is, how do you suggest, then, that monetary policy should be operated so as to affect all of the economy, including consumer credit?

PROFESSOR SAWYER: I think this is a very difficult question to answer. I am sure I have not got the answer to this.

COMMISSIONER BROWN: You see, what I am getting at is, if you say the rest of the economy is affected but not consumer credit, because you cannot do things so violently with consumer credit, and in the past it has not been affected -- then you go on to argue against specific controls which, it can be implied, would bring it also under the umbrella of general policy. If general policy does not affect it, and you are against specific controls, I am not sure what this thesis is.

PROFESSOR SAWYER: Let us look at what we are trying to achieve through the use of general monetary policy. Presumably, what is being attempted is either to stimulate spending in the economy generally,

if we are in a period of recession, or to somehow cut back a little if inflationary pressures are threatening. If we look at the record of consumer spending, at least over the last decade or so it has been relatively stable. There has been some instability in the durable goods, but it has not been great, compared to some other sectors of the economy. Indeed, in recent years the whole of consumer spending has been relatively stable. I am not expressing this properly. The rates of increase in consumer spending have been relatively stable. There has not been great evidence in the periods of recession that the economy has been experiencing and in periods of expansion, that the consumer sector has played a large role in these. The instability seems to be in exports at times, in business spending and capital formation. I think there is a suggestion in the brief of the policies which might affect these areas of spending -- and whether or not changes in general monetary conditions affect these is something I feel is beyond my competence to answer at this moment. I presume that the Commission has had the advice of others on this point.

The point I am making is that the past record shows that consumer spending, except for consumer durables, has not been a great contributor to instability in this area. Even if one could make consumer spending on durables more sensitive to general monetary conditions, this still would not be a very large factor in the over-all consideration.

I think, possibly, we are saying that general monetary policy is not going to have a great effect on consumer spending, but I think we are also saying this is not the sector that has been contributing greatly to the instability of the economy.

Secondly, when it comes to the matter of selective credit controls, I think it follows that if the consumer sector has not been contributing greatly to the instability of the economy, that we have seen, why should it be singled out for any special treatment?

Thirdly, we are making the case, I think, that selective credit controls are probably difficult to administer, and it is sometimes hard to achieve their objectives. We do concede that in a period of emergency, which might be a period in which something happened that caused rather sharp inflationary pressures to occur, they might be used under those circumstances. However, I think we must distinguish between the periods of sharp inflationary pressure, which might be associated with a war or some other national emergency, and the type of business cycle fluctuations we have had during the latter part of the 50's. I have rambled a little bit, but have I answered your question?

COMMISSIONER BROWN: I think you have come back to my original question, that your general thesis is that consumer credit is not a factor and therefore should not be controlled. Is not this just about it?

PROFESSOR SAWYER: It is the word "should" that is bothering me. I am saying, really, all forms of spending. Let me see if I can phrase this the way I want to. Any sector which is contributing to the instability of spending, one would expect, would have some responsiveness to general changes in monetary conditions. In recent years I do not think this instability has been in the consumer sector; and probably this is the reason, in part, why changes in monetary conditions have not affected it. If a situation did arise where the consumer sector somehow got out of line with the rest of the economy -- and I do not know what you use as a measuring rod for this ---

COMMISSIONER BROWN: This is what we were trying to get at earlier.

PROFESSOR SAWYER: --- in terms of contributing to the general inflationary pressure in the economy, and with no other solution to the problem apparent, I would think the emergency use of selective credit controls would not only be necessary but quite acceptable.

COMMISSIONER BROWN: How about fiscal controls over consumer spending generally?

PROFESSOR SAWYER: I have talked mainly of the effect on interest rates. By fiscal controls you would mean changes in tax rates which would affect the amount of disposable income the consumer would have for spending.

COMMISSIONER BROWN: And such things as

sales taxes.

PROFESSOR SAWYER: Yes. On the income side certainly changes in income tax rate are one of the general methods of monetary-fiscal control, and one, of course, should be using an appropriate mix, depending on the circumstances at any particular time. This is simply a decision on the part of government to reduce the income available for spending. It does not single out any particular use of that spending power and say, "This particular use should be curtailed": it does restrict the total spending; and I think this is non-discriminatory and quite consistent with the general position we have put forward here.

Again, a general sales tax is non-discriminatory. If it applies everywhere it is an alternative device either for reducing spending power or raising some additional funds, or a combination of the two.

I think we are trying to distinguish between things that apply generally and the singling out of a particular sector or sub-sector for special control in a situation where there appears to be no emergency requiring this. But we are certainly not saying the government should not use appropriate monetary-fiscal policies to reduce total spending in the consumer area, if it feels it appropriate to do so. Certainly, fiscal policy may be the best way of achieving this objective, if it appears that policy, working through interest rates and so forth, does not produce responsiveness on the part of consumers.

COMMISSIONER BROWN: That is what I was leading up to.

COMMISSIONER GIBSON: On the question of the importance of consumer spending as a matter of variability in the economy: your statistical analysis is not open to question, but I just wondered if you have given any weight to the place of the automobile and the automobile industry in the North American economy today. Admittedly, you are not selling automobiles, but there is an argument the other way, that the fortunes of the automobile industry have been variable these last 10 or 12 years, and they have had quite an effect on business attitudes, and therefore expenditures in this area are a little more important than the figures themselves suggest.

PROFESSOR SAWYER: I would agree with this, sir. It is possible this may be a little more true in the United States than it is in Canada; but this is certainly generally true. It is a key industry, because of the effects of the purchases of materials and so forth by this industry on other industries. As in this and many other areas, things that could produce more stability in sectors of the economy such as this would undoubtedly contribute to greater over-all stability.

COMMISSIONER LEMAN: Mr. Chairman, I would like to change the subject now, if we are through on this point.

THE CHAIRMAN: Yes.

COMMISSIONER LEMAN: The Federation has

concentrated on this matter of consumer credit in its brief and has not discussed very much what happens to the retailers as an industry. Does the Federation get any information from its members regarding the source of the funds they use, their capital structure and the difficulties they encounter in the capital market? Does the Federation take an interest in this for its members?

MR. WOODS: This is not particularly a problem of the Federation, and I would say "no" in answer to that question. But while we have views on the financing as individuals, of how companies are financed as to their receivables, their inventories or their expansion plans, the Federation makes no particular point of attempting to cope with the financing problems of its members. This is possibly more a problem of the smaller retailers, although they seem to be, in most cases, reasonably well financed, and that would be dealt with, probably more competently, by our association members rather than the Federation members.

COMMISSIONER LEMAN: So the Federation, as such, would not be in a position to give the Commission now a typical cross-section of the capital structure of retail establishments, divided any way you like by broad classes as to size or fields of retailing, or that sort of thing? This is not even available to the Federation as such, is it?

MR. WOODS: In terms of capital, I would say, "no". In terms of sales volume, there are

some statistical figures available as to the grouping of volume by size of sales. Those are Dominion Bureau of Statistics figures, and my recollection is, of 1960, that those stores that were regarded as small and independent in the food field, excluding automobile, gasoline stations, second-hand and auction field -- that stores doing less than $2 million per annum and having no more than one or two branches -- and I have forgotten the definition of a"chain store", but such smaller stores did, in 1960, 57 per cent of the total retail volume of the country, and the remainder was done by the larger corporate retailers. These figures have changed slightly over the last 30 years. In 1930 the similar sized groups of stores represented 64 per cent of the retail volume, so in 30 years there has been a drop on the part of independent retail business of from 64 to 57 per cent. In terms of their capital, I do not know about that.

COMMISSIONER LEMAN: Without looking at any tables that would give us that kind of cross-section, could we nevertheless ask you, as independent witnesses here, if you have observed any changes, let us say since the end of war, in sources of funds used, say, by large retailers?

PROFESSOR SAWYER: I have not examined this.

MR. WOODS: Would you care to hear about our business?

COMMISSIONER LEMAN: Let me ask some

specific questions. For instance, has the leasing of capital assets, the sale and leaseback of premises, say, developed in that period?

MR. WOODS: Yes, I would think substantially. In our case -- and I can only speak for our company -- we have entered into ten shopping centres in the last several years, and those are all leased. We have, in addition, expanded to units which we have owned and have leased them back. They have been sold to an insurance company, which has leased them back. The general expansion and acquisition of other stores we have largely undertaken on a rental basis. We own about one-third of our retail premises, and two-thirds we lease, either in shopping centres or conventional down-town locations.

COMMISSIONER LEMAN: Would any figures be available on this on a national basis, the extent to which this has developed for the industry as a whole?

MR. WOODS: Professor Sawyer, would you know of any statistics?

PROFESSOR SAWYER: No.

MR. WOODS: Mr. Southmayd?

MR. SOUTHMAYD: No general figures, that I am aware of.

MR. WOODS: Mr. Creaghan?

MR. CREAGHAN: No, and they would be difficult figures to obtain, I would imagine, unless you could get them from the Bureau of Statistics in Ottawa.

COMMISSIONER LEMAN: How about some other

new forms of financing for retail establishments? Some large retail companies have used the short-term money market to some extent.

MR. TATE: I think that is a new advent in the last five years or so, and particularly the banks entering into that field of shorter-term financing for expansion purposes.

COMMISSIONER LEMAN: How do you think this has been used? Is it being used as a regular source of funds by those who have used it?

MR. TATE: In certain cases it is replacing, say, the mortgage market; it is of shorter duration, of course. I am speaking without full knowledge, except for the fact that when our firm entered into it it was a new departure for us. Leasing was a new departure, and then obtaining funds for expansion through shorter bank financing was a departure in our case.

COMMISSIONER LEMAN: Do you think this use of short-term funds, perhaps on a roll-over basis, as a regular source of funds has displaced bank borrowing, or displaced what?

MR. TATE: It has displaced, to some degree, mortgage borrowing, the banks' introduction into that field. Am I clear there?

COMMISSIONER GIBSON: I think,Mr. Tate, Commissioner Leman is talking about borrowing money from the bank instead of the mortgage market. I do not think that he is talking about the short-term money market ---

MR. TATE: I think his is shorter term than what I am talking about.

COMMISSIONER GIBSON: Short-term or commercial paper.

MR. TATE: Yes, that is different.

COMMISSIONER LEMAN: My question was the use of the money market by large retail establishments. You have no figures to give us on that?

MR. TATE: None.

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COMMISSIONER LEMAN: Your brief mentions that there are in Canada somewhere around 180,000 retail outlets. Does that figure have any relationship in your mind to the availability of financing for retail businesses? Does the fact that there is a large number of retail outlets have anything to do with the facility of financing that type of business, or does it have nothing to do with the availability of funds?

MR. TATE: I am afraid I have never thought it through to that degree.

MR. UPSHALL: Is it not true that there has been a trend towards the larger organizations having acceptance companies and issuing debentures against them to the public? Is that not basically the method of financing in the retail trade?

COMMISSIONER LEMAN: Do you mean financing the whole retail business, or just one section of it?

MR. UPSHALL: I am thinking of just the credit section of it.

COMMISSIONER LEMAN: But with respect to the larger establishments you are telling us that they are financed separately from the premises, and that sort of thing, but that is not the case with respect to the smaller establishments. The smaller establishments use the whole pool of funds that are available for that establishment to use.

MR. WOODS: I think on that point supplier credit, particularly from wholesale distributors, provided a substantial part of retailers' credit.

We had up until a few years ago quite a substantial distributing business,and credit extension was a fairly important part of our function. It became less so during the 40's, but at the turn of the century, certainly, it was very important. I think many of our customers financed themselves quite a bit by our credit terms which were longer than ordinary consumer credit terms. We had a high figure of accounts receivable which we financed by bank borrowings.

MR. ELY: Did you give longer terms than consumer credit terms?

MR. WOODS: Yes.

COMMISSIONER LEMAN: Let us talk about those establishments that have to finance the credit they have to extend to customers out of their total pool of funds. Have you any idea of what proportion of their total funds invested is invested in that particular sector ofthe business?

MR. WOODS: No.

COMMISSIONER LEMAN: How about the retailers themselves -- have they been significantly affected by these changes in credit availability? I am talking about tight money conditions and easy money conditions. What has been their response?

MR. WOODS: I suppose that is largely dependent on what sort of development plans they had on hand and their own financial strength and the need for additional financing. I wonder if Professor Sawyer has any views on this in general terms. Perhaps other members are prepared to give their experience.

MR. ELY: No, I have not.

COMMISSIONER LEMAN: Are the large concerns better able to sail through these periods of tightness, and is it just the little ones that are more affected?

MR. WOODS: No, I do not think that is right. I am quite interested in seeing smaller retailers around the country, and in the last week I have been in half a dozen towns and talked not only to our own store people but to others. It seems to me -- and I am quite surprised at this -- that the strength of the smaller retailer continues to be considerable, provided he has a reasonable margin and provided he is a reasonably good manager. On the whole, he is doing a good job.

We are having the pants kicked off us by a little store in one community that is in the business of piece goods. The girl who runs this business has personality and skill, and she is running the business very successfully and, in fact, is running ur ragged, bless her heart for it. That sort of thing is being done all the time. Small retailers are doing exceedingly well, despite all other competition. It is surprising to me that this is continuing. The good retailers, small or large, are continuing to do a good, profitable business. I do not know of any good small retailer who is not doing a good job despite all this tough competition.

COMMISSIONER LEMAN: But what we are talking about is the cycle here. Is he relatively better able

to provide competition in times when credit is difficult, or is he less able to do so when credit is difficult?

MR. ELY: If I might answer with respect to Mr. Woods' remarks, I will say that the competent small retailer who is making a reasonable profit and who is ploughing back a reasonable amount back into his business, and who is using, as we do, the banks and his own profit as the only source of capital, is not influenced to any great extent by either tight or loose monetary policies.

Our outlook on planning may be affected, but I do not think our day-to-day business is in any way affected. This is a personal observation. I think, in the light of what Mr. Woods has said, that it would not affect any retailer who has his feet on the ground. Perhaps this is irrelevant -- I do not know -- but this does not affect us as a small retailer.

MR. CREAGHAN: I would agree with that. We have five stores in the Maritimes, and down there we have a less than average revenue. We have found no difference whatsoever since the recent tight money conditions were imposed, or since the devaluation of the dollar, and so on.

I read something interesting about two years ago. I would not vouch for the accuracy of it, but it was in the Financial Post, and it was a statement with respect to the failures of different stores in Canada at that period of time. I think the

report came from Dunn & Bradstreet, and it was their opinion that about 90 per cent of these failures was due to management. Whether a store is small or large I do not think makes any difference. That is my humble opinion, and I may be wrong. I think the whole thing comes down to that. A small person can also be a very good manager. His revenue may be smaller, and so on, but in a general way I would think that the small, the medium and the large would all be very much in the same condition so far as that is concerned -- that is, proportionately in the same condition.

COMMISSIONER LEMAN: So, would it be your opinion that the difficulty in financing a retail business has not been a key factor in the growth of small establishments? You think this is all related to other factors such as ability, inventiveness, and so on?

MR. CREAGHAN: I think ability is the big factor.

THE CHAIRMAN: If that is so can you tell us whether in times of tight money conditions there are more failures in the retail trades amongst these less well managed concerns than there would be in times of more expansive monetary conditions.

MR. CREAGHAN: Well, I take the premise that the larger concerns possibly are in a position to get the more competent people to head them. They have, possibly, more available capital to call upon in times of emergency than the smaller retailer has.

THE CHAIRMAN: I am not talking about the big and the small. I am talking about the well managed as against the less well managed.

MR. CREAGHAN: There are some qualifications that may be embodied in the 10 per cent I spoke of, such as these matters of money and better or poorer management. Your question is: Have those failures all been out of the bracket of the smaller merchants?

THE CHAIRMAN: I am not interested in whether they are small or large. In view of the business cycles, where there are tight conditions for a time which are followed by more expansive conditions, are the marginal operators apt to fail and feel the effect of tight money more than the others?

MR. CREAGHAN: Yes, I think they are, Mr. Chairman.

THE CHAIRMAN: So that monetary policy has its effect upon business in that respect?

MR. SOUTHMAYD: Yes, it has.

MR. WOODS: I would think it would be true to say that amongst the small organizations there would be a larger proportion of ill managed concerns than among the big organizations.

THE CHAIRMAN: Yes, but does monetary policy have any effect at all on your business? Apparently it does have some effect, especially on the marginal concern.

MR. WOODS: Yes.

COMMISSIONER LEMAN: For instance, there is

the matter of trade credit. Would you say that the small establishment is more likely to finance a higher proportion of its total needs through credit from suppliers than a large one?

MR. WOODS: I would think so, yes. I think it must be a more important source of credit to them. I would not have figures to support that.

MR. ELY: I would disagree a little bit. I am inclined to think that the well managed small business would be very reluctant to lean on suppliers if it wishes to maintain a credit rating and a worthiness in business. I do not think there would be any tendency to lean any more on that than do other segments of the retailing business. That is only an opinion.

COMMISSIONER LEMAN: Is there not quite a spread of practices? Are not some of the very large retailers sometimes operating in reverse, and financing some suppliers?

MR. WOODS: Yes, they are doing such things as making manufacturing commitments in advance.

COMMISSIONER LEMAN: That is, partly through contracts and partly through payment before delivery, and that sort of thing?

MR. WOODS: I can only speak for our business. I would say that that is not an important factor with us. It is important to a manufacturer to know that he has an assured sale of his product, and that we are undertaking an energetic promotion of the items he may be supplying us with.

COMMISSIONER LEMAN: If there is no more on this section I would like to pass on to another point that is referred to in your submission, namely, the discussion about the disclosure of the cost of borrowing. We have heard from many people about this matter of disclosure of consumer credit. It seems to be a very complicated. It would appear that one of the reasons for not having higher standards of disclosure, without being too concerned about whether it is more useful, is that it is simply too complicated. It has been said that it is more useful to the purchaser if he is told what the total dollar charge is as opposed to what the effective rate of interest is. Can we ask you if this is consistent with your views on how intelligently consumers have been using credit? Can it be argued at the same time that all the purchaser should be given are the elements so that he can make all the calculations that might be desirable?

MR. WOODS: Possibly those who grant credit would have some views on the difficulty of one aspect of this. If it appears necessary that disclosure should be increased, we would support that. We do see, however, some very real problems. There is no advantage to the consumer in his having disclosed to him the percentage cost, but we do think there is some advantage to him in disclosing the dollar cost. That will have some practical advantages, and it is administratively possible. The percentage cost is administratively very difficult to calculate.

I think Mr. Southmayd or Mr. Upshall might have some useful comments to make in this connection.

MR. SOUTHMAYD: I think, Mr. Chairman, there is no disagreement in principle on this matter. We support, as the brief states, disclosure of proper information. The question is as to the manner. I noticed you used the words "higher standard of disclosure", and I am not entirely sure of what you mean by that, but it is our belief that full disclosure in dollars is the standard which the customer can best use in appraising this matter.

It is true that the conversion of the price of credit accommodation to any kind of so-called effective rate is a very complex matter. It is stated in the brief also that there is no general agreement as to how this can or should be done with any sort of accuracy.

As you know, the Banking and Commerce Committee of the Senate went into this to a great extent. The hearings in Washington on the Truth in Lending Bill contains something like 1,300 pages of testimony on the same matter, but there was no agreement among the experts that this was a practical thing to do.

We believe that disclosure in dollars is more effective. In this connection, if you do not mind my taking up a minute or two, there has been an example raised which, I think, illustrates what we are saying. There has been a question raised as to whether a customer is better able to judge the

advantage of a transaction if you give him a rate. Suppose you tell a customer that he can buy a refrigerator, for instance, at $330 and pay for it over 24 months at an effective rate of 15 per cent, or that he can buy the same refrigerator for $320 on the same term with an effective rate of interest of 18 per cent. When you say "effective rate" you are pre-supposing certain conditions which in normal credit practices do not exist, but assuming you can obtain these conditions, can the customer decide on this basis which is the better transaction? It is pretty hard for people skilled in this type of thing to determine which of these two alternatives is the better. It is our belief that disclosure in dollars is the best measure that the customer can use.

COMMISSIONER LEMAN: I do not want to revive the whole discussion we had earlier this morning, but what I have in mind here is the sentence which appears in paragraph 57:

> "... we must -- in general -- assume that provided the consumer fully understands the cost of the credit he is extended, he is making a productive investment."

What is the full understanding of the cost of credit he is extended, in your view?

MR. SOUTHMAYD: The total cost of the transaction in dollars is this measure of what it is going to cost him in terms of his future income.

PROFESSOR SAWYER: I think this is the crucial point, really, that when the consumer gets

around to making his budget for future periods of time an important thing to him is how many dollars in each period he has to pay out. If the cost is given to him initially as an interest rate formulation then I think ultimately he has to translate it back to what it means to him in terms of dollars that he has to pay out this month, next month and so forth.

In this sense I think the expression in dollars is probably more meaningful. The real problem that, of course, comes in is how can he compare different contracts which have different payment schedules, and so forth, and see whether they are really different. This is really the difficult aspect of it, I think, but I think when we say that the dollar cost is more meaningful, that is probably what we have in mind, that ultimately he must translate the price of credit accommodation into how many dollars of his future income will it take to pay off this thing.

THE CHAIRMAN: When you talk about the number of dollars, you mean there would be a separation of the number of dollars that is to be paid for the credit from the number of dollars that is to be paid for the actual sale value of the article?

PROFESSOR SAWYER: Yes.

THE CHAIRMAN: When you talk about full disclosure, you mean full disclosure of the amount per month, or whatever the terms may be of the credit, separate from the amount per month of the article?

PROFESSOR SAWYER: He should know at any future point in time the balance outstanding that has to be paid back, and clearly understand how it is to be paid back.

THE CHAIRMAN: So, he could compare that contract with another contract which might cost a little more per month or a little less per month for the credit?

PROFESSOR SAWYER: If the terms of credit are

completely different it is very hard to standardize these things sufficiently.

THE CHAIRMAN: You could put it into an amount and he can figure out if there is a difference in the length of time of the contract, he can figure that out; if he sees so much a month that he must pay on this contract for the credit.

PROFESSOR SAWYER: Yes.

THE CHAIRMAN: If it is expanded over two years, and another contract might offer him a different amount per month, for instance, and over three years?

PROFESSOR SAWYER: Yes.

THE CHAIRMAN: Or various other combinations.

COMMISSIONER LEMAN: But isn't that the key to this problem; how is this very intelligent consumer going to fully understand the cost of the credit that is extended to him when he compares, say, the purchase of an article that will cost him a payment of $11 a month for 24 months, as against one that would be $9 a month for 32 months; is that what he fully understands when he shops around? Is the average purchaser able to make the necessary appreciation of what the cost of the credit is to him if he is presented with these two alternatives?

PROFESSOR SAWYER: The average is certainly not, no; I agree fully with that.

THE CHAIRMAN: What was that you said?

PROFESSOR SAWYER: I say that the average consumer is not able to compare two such contracts, stated the way Mr. Leman stated it.

MR. UPSHALL: My point of view is that if there

is a refrigerator for sale and it is $300 for cash and if you want to finance it for 24 months, you pay another amount of money, and both these things are stated and the length of the term. If the customer chooses to pay cash, that is fine, it is $300, but if she chooses to have it extended over a period of 24 months, then she pays this additional amount. Now, that is the cost of it.

Our view is that we are disclosing the cash price and the credit pride to her and that that is more meaningful than telling her that she is going to get some kind of a percentage. If she can't calculate the difference between the nine months term, as you suggested, and the twenty-four months term, how meaningful is it to her to be given a percentage effective rate. Will that mean any more? I don't think it means as much; it gives her a common denominator, that is all.

COMMISSIONER LEMAN: You are telling us it is not very important for him to understand all this provided he doesn't get into trouble and manages to make sure that his future income will enable him to meet all the commitments he has made, and that he might be tempted to pay 20 per cent to some one as an effective rate by extending the contract rather than, say, purchase less to accelerate the payments on what he does purchase and pay only, say, 15 per cent, or whatever credit he has used.

MR. CREAGHAN: Is there not a similarity between the retail price of this article and the price

of credit? When this competition gets on the open market it will be forced down to its lowest possible level, one merchant will compete with the other, and therefore the credit is -- if it is not now -- going to be forced down to that competitive level. It is the same way with the retail price of an article; we don't disclose the retail price of an article because it would be a very complicated affair; I mean, there are so many items that go into the overhead. But we know from reports of Dominion Stores that last year they made 1.75 per cent and I think this year it went up to 1.84, or something. We are earning around two decimal something or three decimal something. If we told the customer that we marked 50 per cent or 60 per cent or 40 per cent on the cost, she would be aghast at that large margin, and there is a similarity on the open credit market between this credit and the actual cash price.

COMMISSIONER LEMAN: Well, is the summary of all this to be stated that you don't believe the average consumer considers the investment alternatives very much?

MR. CREAGHAN: Pardon?

COMMISSIONER LEMAN: The average consumer doesn't consider investment alternatives very much; he just wants this article and all he figures is whether he can pay for it from future income without getting into trouble?

MR. CREAGHAN: Oh, I ---

MR. UPSHALL: On the free market he has a cash

price and he has the price for the credit accommodation, which he can go out and shop for and then make up his mind, and we think he should be able to separate this from the price of the article, and we think this is more meaningful to him than to try to express it in rates.

COMMISSIONER GIBSON: You gentlemen have built a model here of an economic family motivated by very fine calculations as to relative costs and relative opportunities, but now it doesn't seem to me you are supporting this model.

One of the things, for example, that an economic man could do is to weigh, against making the commitments, what he might otherwise do with that money, if instead of spending it on a durable goods article he saved it and invested it. You are talking in terms of interest rates, but if you are talking about the cost of money you can see that interest rate comparisons are not irrelevant.I don't question the difficulty of doing this.

PROFESSOR SAWYER: I think where they are precise the comparisons are allowed.

COMMISSIONER GIBSON: Arguments have been presented to us that they are no more relevant than the cash cost of the goods. I don't say that the cash cost of goods is determined in a competitive market, but you are talking about credit and the importance of people knowing how much they are paying for it. It seems to me that is a quite different thing than knowing what the retailer's profit or sales

margin is.

MR. SOUTHMAYD: In connection with your suggestion that the consumer might want to decide whether to invest his money, or spend it, this question of how he will use his money doesn't only apply to whether he will buy on credit and pay the price for credit accommodation, it is tied up with the whole price situation. He may decide not to buy it because of the price of the merchandise. This is a price for a service, and he decides whether he will buy this service at the price, the same as he will decide whether he will buy the merchandise at that price.

COMMISSIONER GIBSON: I agree with you, that is the argument you are making, he has a whole lot of alternatives open to him, and all I am saying to you is that some of these alternatives are expressed in interest rates and you say that these should be expressed in the form of a finance charge. I understand your reasons, but I don't know that they fit in very well with the model of an economic man as between these various alternatives.

THE CHAIRMAN: If there is such a thing as this hypothetical man, I think the first thing he would say when he saw the contract was, "I want to know what the interest rate is and I will not buy it unless I know," and if he doesn't ask that he is not a model economic man!

MR. WOODS: Might he not also say, and still be quite rational, "I wonder whether I can absorb these costs within my budget; I am concerned with the dollar

costs rather than the interest rate, and the dollar return from the investment is equated with the dollar cost of financing the purchase."

THE CHAIRMAN: Perhaps the weakness of your position is that you introduced this economic man.

MR. WOODS: Well, he presented a fair amount of jollity during the morning!

COMMISSIONER BROWN: I think that this interest rate can become a factor. Say that he is buying something that costs $500 or something that he will have to finance to the extent of $500, he has the alternative of selling a bond of his own that has already cost him or on which he was paid a certain rate of interest, and in this way recovering a certain number of dollars, but how can he make this comparison unless he has it in interest rate form?

PROFESSOR SAWYER: The rational man who can calculate the yield on the bond would also be able to translate the other way into dollars and cents.

COMMISSIONER BROWN: But why should he be able to ---

MR. TATE: He knows that he is getting so much on the bond and he knows that this is going to cost him so much in dollars and he can compare the two, surely.

PROFESSOR SAWYER: I think that there is a point here that is being overlooked; that if you have the information one way or another, and it is complete, then it either can be expressed as a series of dollar payments or as an interest rate.

Now, I think what the people who have the problem of presenting this information, what the retail people are trying to say here -- at least from the practical viewpoint of the retail administration --is tha they find it more feasible to present a schedule of payments in dollars and cents than to go through each individual contract, but with complete information one can be translated into the other.

COMMISSIONER BROWN: There is a reluctance to disclose, in additon to the dollar cost, that this involves an interest rate not in excess of X per cent.

PROFESSOR SAWYER: I wasn't aware there was a reluctance. I am stepping out of my capacity now.

COMMISSIONER BROWN: It says here:

> "...those bills that require the total cost constituents of credit service charges ... to be expressed as a simple interest rate, are misleading, confusing, incorrect and unworkable."

It doesn't say "reluctant".

MR. WOODS: Well, there is this matter of the difficulties in expressing an interest rate.

THE CHAIRMAN: I don't think it is necessary to explore this much further. I think we can see your position and understand it thoroughly, and I don't know that we need to continue this and allow for some refinements; I think it is perfectly clear to us.

Is there anything further?

COMMISSIONER GIBSON: I have one other question on this: the brief does say that:

"...such a requirement would tend to promote the deterioration of true cash sale prices and thus bring about unfair practices which would harm both the cash purchaser and the instalment purchaser."

Do you really believe this? If the cost of credit is determined in the market place, and it is a competitive situation and the cash price is determined in the market place, why would this happen?

MR. SOUTHMAYD: Yes, sir, we believe that it will happen because of the practical impossibility of doing this conversion that we have been talking about.

COMMISSIONER GIBSON: I understand that; that is the great difficulty about it, but you are saying that if it were done the cash purchaser might suffer. Is this really so?

MR. SOUTHMAYD: I think one of the things that we are saying is that because of the practical impossibility of doing what would be required, you might have to absorb the price of credit extension in the over-all price of the merchandise.

THE CHAIRMAN: Absorb the costs of the impossible?

MR. SOUTHMAYD: Impractical and impossible.

THE CHAIRMAN: Well, gentlemen, we are very much obliged to you for the very interesting dis-

cussion we have had on this most admirable brief; obviously it was prepared with great care and we are very much indebted to you for the assistance you have given us in our deliberations.

MR. WOODS: May I on behalf of the delegation express our thanks to the Commission and to yourself for the very friendly and helpful attitude which you have taken towards us today.

THE CHAIRMAN: Thank you very much.

Before calling the Retail Merchants' Association we will adjourn for about five minutes.

--- Short recess.

THE CHAIRMAN: We shall now proceed with the submission being presented on behalf of the Retail Merchants Association of Canada Incorporated and the Equitable Income Tax Foundation.

MR. GILBERT: Honourable Dana Harris Porter, Chairman, and Commissioners of the Royal Commission on Banking and Finance: It is my honour to appear before the Commission on behalf of the Retail Merchants Association of Canada and the Equitable Income Tax Foundation. The submission to be presented is in two parts. Part 1 is the submission of the Retail Merchants Association of Canada, for whom I am the official spokesman in the capacity of national general manager. Part 2 is the submission of the Equitable Income Tax Foundation, which is a new body formed by business groups from across Canada. I appear on their behalf as president of the Foundation. My name is David A. Gilbert. Perhaps, Mr. Chairman, numerically and physically this is the smallest delegation to appear before you.

THE CHAIRMAN: Thank you very much, Mr. Gilbert. We shall proceed with questions.

COMMISSIONER LEMAN: Mr. Gilbert, we heard this morning from the Canadian Retail Federation, who explained to us whom they represented. Could you very briefly tell us the main difference between your association, the Retail Merchants Association of Canada, and the Canadian Retail Federation?

MR. GILBERT: The Retail Merchants Association of Canada is a voluntary organization founde

in 1896 and incorporated by an Act of Parliament in 1910 to promote the industrial and commercial interests of the retail merchants of Canada. Our head office is located in the city of Toronto, and provincial offices are located coast to coast. The affairs of the association are governed by retailers who volunteer their services.

COMMISSIONER LEMAN: Mr. Gilbert, I do not want to interrupt unnecessarily but whatever is in your brief we have read and it is not necessary to put it on the record. Could you just briefly say whether you represent a large number of small retailers whereas the Canadian Retail Federation tends to represent a smaller number of larger retailers? Is that about the main difference?

MR. GILBERT: I think a word of explanation is in order here. As I mentioned, our charter designates:to promote the retail interests of Canada. Our representation consists of retailers who are predominantly the small and medium-type merchants who subscribe to our association their support on a direct basis. We have no affiliations such as does the Canadian Retail Federation. Our membership is direct. We represent over 33 trade categories. Everyone in the retail business, large and small, is eligible for association. Our membership across Canada on a fluctuating basis stands at approximately 25,000, but there are many more who do not subscribe to the organization on a voluntary basis but depend upon our representations as their official spokesmen.

COMMISSIONER LEMAN: What is your main procedure to help your members? What sort of information and statistics do you gather from them in order to establish the broad areas of improvement that you should work on for them?

MR. GILBERT: We service our membership right across Canada from our national organization. Our material is sifted through our member organizations and their provincial offices by way of bulletins, trade magazines, and so on. Unfortunately we are not financially able as yet to get into the field of statistical work or research to the extent that we would like. However, a good deal of our work is along the lines of distributive education. We are endeavouring to make better retailers, particularly out of the smaller and medium-size retailers, and keep them daily informed on changing trends in retailing. In addition to this we give them representation before industry and before government.

COMMISSIONER LEMAN: One of the main points you make in this submission is that the small retailer has difficulty in financing his business.

MR. GILBERT: That is right.

COMMISSIONER LEMAN: That is one of the main points. In your view what is this due to? Is it mainly because of the managerial level available in that sector or is it the fact that our capital market is not properly set up to service this industry?

MR. GILBERT: In our submission we have made a point on both scores, sir. We point to the need,

in today's competitive and expanding retail industry, for managerial competency. We have also made a point that the available capital has traditionally not been easily attainable by the smaller type and medium-size merchant. We have spelled out his sources of capital as being short-term loans from banks, monies financed through his suppliers, some assistance to date through government - guaranteed small loans for business improvement. Beyond this, apart from his personal friends and relatives his sources of capital are restricted.

COMMISSIONER LEMAN: On page 9 of your brief you say:

> " In the transition between a small-scale and large-scale operation, the independent operater is handicapped by his lack of capital resources..."

Well, how have the ones that have passed from being a small establishment to a larger one solved this?

MR. GILBERT: Through a combination of management competency, through the general efficiency which was above average to be found in the industry, and very often through the efficient utilization of the capital available and taking a share of the profits and ploughing them back into his business.

COMMISSIONER LEMAN: Are you telling us, Mr. Gilbert, that the capital market is so set up now that even on investments which would provide a good, safe margin of yield, a reasonable risk is not being supplied by the institutions that are in the market

of supplying credit?

MR. GILBERT: We have made reference to this situation by saying that an easier flow of credit is necessary, which would imply that the present sources of capital are not now sufficient to meet the requirements ~~of this~~ type of merchandising.

COMMISSIONER LEMAN: This is an opinion. You make that assertion: how do you document it?

MR. GILBERT: It is an item that is extremely difficult to document. In our numerous appearances before government bodies in advocating the enactment of a government programme of financial assistance, we did make, I do believe, a convincing case as to the need for some government programme of assistance for small business and we now have a federal Small Businesses Loans Act.

Another point we have made in our brief is that it is almost impossible to tabulate the kind of statistical information in Canada which is required to come before this Commission or any other with facts and figures. The network of organization of our Association that we have outlined in our brief is such that our directors are from all parts of Canada and represent many municipalities. The representatives of our organization virtually enter every business community throughout the nation at least once a year. In this capacity we employ about 100 people, whom we call our Retail Merchants Association counsellors. They call on the trade and our information comes largely from the views which are passed through our board of directors on this representative basis and from

reports submitted by our field organization.

COMMISSIONER LEMAN: There is one particular point you have made in your brief, Mr. Gilbert, that I should like to ask you about. I would not call it an assertion but at least your opinion is that the sales volume importance of chain stores will tend to become rather stable when they amount to about 28 per cent of total retail sales volume. What is this opinion based on?

MR. GILBERT: We have based this opinion on our studies of the market. I might say that this brief has been prepared in consultation with Professor James M.A. Robinson, who was retained by the association as an adviser in the preparation of this brief. Professor Robinson is a consultant in marketing management and is the author of several articles in the areas of education for business, retailing and marketing management. He has been honoured as a biographer in the Thirty-Second edition of "Who's Who In America".

In making the statement, we have appended to our submission a series of charts which trace the development of retailing in Canada since 1931. I would refer the Commission to Table 5 setting out the volume of sales and the per cent of market by chain and independent stores between 1930 and 1960. The source of information is the Canada Year Book, 1961. In 1930 the total retail sales of chain stores amounted to 17.8 per cent and the total independent retail sales amounted to 82.2 per cent. You will

radically. The reduction of the independent share has been a gradual process, and in the periods between 1930 and 1950 it can be seen from the charts that the independent store, year after year, has made recoveries and the industry has stabilized itself. We foresee with the advent of the discount house no change in that historical pattern of retailing.

COMMISSIONER LEMAN: But does the cause lie in the competitive advantages the small, nimble independent retailer might have?

MR. GILBERT: Yes, but it goes beyond that, sir. Canada has been pioneered by small business. It is still a country of relatively small communities, apart from a limited number of urban centres, and the independent or small and medium-type retailer remains a very important segment of business in Canada. He is adaptable and able to meet changing times, although sometimes he is much slower in doing so than his larger competitor.

COMMISSIONER GIBSON: Mr. Chairman, I should like to ask Mr. Gilbert a few questions about the consumer credit end of retailing. You say on page 12 of your brief:

> "In view of the seasonal variations in retailing and the burden the extension of credit places on the working capital resources of retailers, this level -- "

That is the present level --

> "... this level of consumer credit is particularly significant. During the

coming years, the extension of credit by retailers will become increasingly great."

You feel there is a strong upward trend in credit extension, I take it, do you?

MR. GILBERT: Yes, sir, we do. We have endeavoured to indicate this on the charts appearing as appendices to the brief in connection with consumer credit.

COMMISSIONER GIBSON: Have you got it forecast? I have seen your tables but do you have a forecast?

MR. GILBERT: We would make no forecast except to say that if the economic barometers remained the same, the trend upwards would continue at the same average rate as in the past.

COMMISSIONER GIBSON: You are really saying here that you are a bit concerned about this from the standpoint of obtaining the required funds, is that correct?

MR. GILBERT: Yes.

COMMISSIONER GIBSON: In looking at the increase in consumer credits provided by retailers, the increase is almost entirely in instalment sales and not in charge accounts. Charge accounts have been fairly stable. Am I correct in assuming that the problem lies largely in the provision of instalment finance? It is Table 11 which gives this breakdown.

MR. GILBERT: Yes, this is correct. One of the problems, and I think some of this was touched

observe that through the years 1941, 1951, 1952 and 1953 the independent share rose to 83.1 per cent, then dropped to 82.2 per cent in 1954, but it has maintained an average to 1960 between 79 per cent of total retail sales in Canada, and 83 per cent.

We recognize that some of the changes in retailing have been almost revolutionary. We make reference in this connection to the large type discount store which is making its appearance in Canada. For this reason we feel the chain-store type of operation will expand to the point that we have forecast this figure.

COMMISSIONER LEMAN: That is what puzzled me a little bit, why you felt this curve would flatten out at 28 per cent.

MR. GILBERT: This would be a natural development, having regard to the past history of retailing in Canada.

COMMISSIONER LEMAN: But do you have an opinion as to what the causes of this are? Why should we accept this performance?

MR. GILBERT: Based on the 30-year period we have just reviewed; first we had the innovation of the department store and then we had the introduction of the chain food store, which has certainly made its impression on the food industry. However, the over-all sales resulting from the development of these new type retail outlets, and their expansion -- most of them of a corporate nature -- have not had such an impact on total retail sales as would reduce the independent

on this morning by the previous delegation, is that there have been certain changes in recent years in the charge field in relation to instalment purchasing. It is not an uncommon practice today to extend charge account facilities and then, 30 days following, to accommodate the customer by changing these arrangements at their discretion or at their will to a revolving charge account or to an instalment payment account. I think perhaps this may account for some of the fluctuation in 1957-58-59, according to our chart. But very definitely there has been a forward movement in the instalment purchasing, and this has posed the problem that we outlined in our brief in connection with the smaller and medium-type retailer.

COMMISSIONER GIBSON: These figures for instalment credit apply to the whole retail business, the big departmental stores, and so on?

MR. GILBERT: Yes.

COMMISSIONER GIBSON: What about the smaller retailers? Do they stand, in so far as instalment credit is concerned, on their own or do they depend on finance companies or what?

MR. GILBERT: They use a combination of arrangements. I would say that ordinarily they use the services of an acceptance corporation or finance corporation. At other times, particularly in respect to charge accounts, they attempt to carry this credit on their own books, sometimes assisted by short-term loans and financing from the banks and, occasionally from suppliers, by extended datings.

But the suppliers' credit is tightening up very much. So, in the majority of cases for retailers located in urban centres and medium-sized towns the instalment arrangements are placed through acceptance corporations. The retailer in the smaller town has a real problem in extending these credit facilities to residents of their communities. The facilities are limited as compared to the credit facilities available in the neighbouring towns or cities.

COMMISSIONER GIBSON: Do the small retailers in the smaller centres send customers around to the banks for credit? Do they use that sort of financing?

MR. GILBERT: We have given them encouragement to do that.

I might say that during the early 40's in Western Canada there was a situation we encountered which involved our organization in promoting the idea among our membership in 300 or 400 towns, in the three Prairie Provinces, of going on to a straight cash basis. Part of the programme was to inform and educate retailers to inform and encourage their customers to approach the banks and other lending institutions for the necessary money to replace the credit arrangements they were requesting from stores.

COMMISSIONER GIBSON: Did this work?

MR. GILBERT: It worked excellently in two hundred towns.

COMMISSIONER GIBSON: It has expanded then, has it?

MR. GILBERT: Unfortunately it has not expanded. Competition being what it is, many of these stores in fields other than food stores, have now found it more desirable to go back into the credit picture. Here again it stems from competition.

COMMISSIONER GIBSON: Is this because credit-granting is profitable or they have to have the services right with their premises?

MR. GILBERT: The service on their premises is almost vital to meet competition and to plan for business growth today.

COMMISSIONER GIBSON: In other words, you have to do the whole business at once?

MR. GILBERT: Yes, sir.

COMMISSIONER GIBSON: What do you think about

consumer credit? I take it you were here earlier this morning. Have you any views, or has your association any views as to what the appropriate limits on the extension of consumer credit are?

MR. GILBERT: We have not expressed those views in our brief rather delibertately. I think such views might be highly controversial, and I believe they are entirely dependent on the economy itself.

COMMISSIONER GIBSON: Are your smaller members at any disadvantage in competing with larger stores, if they use the services of a finance company for instalment sales?

MR. GILBERT: Not generally speaking; and the history of retail sales in Canada will bear me out.

COMMISSIONER LEMAN: I gather your answer to Mr. Gibson's question is that it is not a competitive disadvantage for the small retailer?

MR. GILBERT: Only in the smaller areas where he is unable to make appropriate arrangements for financing his paper. The expansion of consumer credit is posing a real problem to retailers, of whom we are discussing, in finding the necessary capital adequately to carry his accounts receivable over and above any arrangements that he has made with acceptance organizations.

COMMISSIONER GIBSON: There has been relatively little increase in the charge accounts over the period and , presumably, they are being financed as they used to be -- partly out of their own capital

and partly out of bank loans -- is that correct?

MR. GILBERT: Yes, this is true. Sometimes at the expense of merchandise on the shelves.

COMMISSIONER LEMAN: Mr. Gilbert, I have a couple of other questions I would like to ask you about the position of the small retailer.

On page 13 you make this statement, which I shall quote:

> "Short-term bank loans contribute to the ability of the retailer to meet his seasonal inventory requirements but they are seldom of sufficient amount or duration to promote a more rapid rate of his business expansion."

I would like to understand why you believe this is so. Is it because the retailer does not use bank credit properly, or the banks will not extend the type of credit that he needs, despite the fact the bank would get a reasonable risk in extending the appropriate credit?

MR. GILBERT: I believe the point here is, as explained in an earlier section of the brief in which we have pointed to the growth development by sales and by operation in the retail establishment, and we have produced a chart to appraise this growth, with the result that the retail outlet today is averaging in net sales a tremendous expansion over what the comparable outlet was doing, say, 10, 15 and 20 years ago.

In order to increase sales these retailers are faced with the need to purchase and finance

additional inventories on a seaonal basis. Their capital structure may be such that their short-term lending arrangements with the bank are limited to such an extent that they experience extreme difficulty in raising the additional funds to purchase the additional inventory necessary to increase their turn-over.

COMMISSIONER LEMAN: That is because their own capital structure is not the correct one in order to support the amount of bank credit they need, is that it?

MR. GILBERT: Not necessarily. I would not make this statement, for the simple reason that ordinarily, through the banks -- and this condition maintains -- the access to borrowing by the independent retailer, while improved in the last five years, still remains limited when it comes to terms of expanding his operation. As you understand, sir, the banks are limited in the type of collateral that they can accept from these businessmen.

COMMISSIONER LEMAN: In general, what is the list or range of sources of funds for small independent retailers? Is that quite limited -- equity capital and bank loans -- or is it more than that?

MR. GILBERT: Those are two of the principal areas. Then there is the share of profits which it is possible to pour back into the business, and credit from suppliers.

For instance, in the food field this form

of credit has virtually disappeared, certainly for the independent retailer. Where there were generous datings prior to World War II, the trend to cash-and-carry and to the superette and larger supermarket type of operation, and the general trend in efficiency have accounted for almost the total elimination of credit from the suppliers of food stores. Seven days dating might be the best in many cases.

COMMISSIONER LEMAN: This is a special problem in that area of food retailing?

MR. GILBERT: Yes, this is a development that has occurred in the food industry. Datings in other industries are considered generally good, but we must realize that suppliers are not in the loans business nor in the financing business, and here too they find it necessary to restrict the amount of credit and sometimes to restrict the duration of terms which are granted.

On the basis of turn-over in a retail store we must consider that datings of 30 or 60 days are not sometimes sufficient to move the major part of the stock which has been purchased on a seasonal basis.

COMMISSIONER LEMAN: Mr. Gilbert, you make a number of recommendations on pages 21, 22 and 23, and since this Commission is still in the fact-finding stage of its work I do not think we want to discuss each recommendation with you. This is not the time to discuss them, but it is just to get the background for recommendations which you make, which you can

be sure will receive careful consideration by us. However, there is one more question I would like to ask you as background for appraising one of your recommendations, and it is the point you make on page 15. You describe for us there how for a certain type of departmentalized specialty store a sales volume of $500,000 would be a large-scale operation, but that for a small dress shop, with two or three employees, that would be a small-scale operation compared to a department store with many times that number of employees and over $1 million in annual volume.

In searching for criteria as to what is a small business, is your argument here the ratio of profits to sales is widely variable, or the ratio of capital requirements to sales?

MR. GILBERT: The ratio of profits to sales is widely varying.

COMMISSIONER LEMAN: Is the ratio of capital requirements to sales widely variable too?

MR. GILBERT: Yes.

COMMISSIONER LEMAN: So both factors are variables?

MR. GILBERT: Yes.

COMMISSIONER LEMAN: Does that create a problem in arriving at a good definition of "small business" so far as retailing is concerned?

MR. GILBERT: We recognize the fact there is a problem involved in defining a small business for the purposes of the Act; this has been a source

of some difficulty to the Finance Department. However, we feel that it is unsatisfactory to define "small business" with a sweeping statement that a small business is one whose revenues during a fiscal year must not exceed $250,000. We feel that "small business" can be better defined by its money requirements. Presently the Act stipulates that an aggregate amount of $25,000 can be borrowed on the basis of security and the government guarantee by small business, and we suggest to your Commission that this money requirement in itself is a satisfactory definition of "small business".

COMMISSIONER LEMAN: Would it be better to make the definition more subtle, to take on more variables in the definition, that would give proper weight to these variables?

MR. GILBERT: We consider this volume definition as not the best approach in an effort to define "small business"; and it has certainly created obstacles for the operators of small business in approaching their banks for these government-guaranteed loans.

Simply to make a point: A food store that is doing $250,000 a year is a very small operation, and yet a men's wear store or a ladies' apparel store, or an applicance business, that is doing $\$\frac{1}{4}$ million a year is a substantial operation. So, we feel that to attempt to define "small business" and to restrict the lending under the definition as it presently stands is incorrect and could be, for practical purposes,

corrected.

COMMISSIONER LEMAN: In your recommendation you say: Remove the gross revenue limitation?

MR. GILBERT: Yes.

COMMISSIONER LEMAN: Are you suggesting it should be an ad hoc decision by those who administer the Act in each case, to make sure they are in the small business field, or not?

MR. GILBERT: I am suggesting this limitation be removed entirely from the Act, with no substitution, and that the application for a loan or loans up to the amount of $25,000 in itself is descriptive of "small business". Obviously, the larger organizations bent on the improvement described within the Act or modernizing programmes, are more often involved in major expenditures far beyond $25,000.

COMMISSIONER LEMAN: The person who administers the Act, if he receives a request for a$25,000 loan, should he make sure that the applicant does not have other good sources of credit for that particular $25,000, or what?

MR. GILBERT: The Act, if I am correct, in its present form does not make this stipulation.

COMMISSIONER LEMAN: That is all I have on that score, Mr. Chairman.

COMMISSIONER BROWN: I have one point of curiosity. One of your recommendations is that:

"Government sponsored loans for Small Business should be more vigorously promoted by the Chartered Banks and the

Federal Departments of Finance and Labour."

Would not this be a more appropriate objective for your association to carry out?

MR. GILBERT: Yes, and we are doing as much as we can.

COMMISSIONER BROWN: Why do you need this other?

MR. GILBERT: I have made reference to the lending experience of the Small Business Loans Act during the year 1961, and I have also made reference to the fact that the number of loans in comparison to the number of chartered banks in Canada is an indication that there is a large number of bank branches who have not processed a single loan.

It is reported to us, in numerous instances, that applicants for these loans have been experiencing and continue to experience difficulty in approaching some local bank managers and, perhaps, this is the minority, for sympathetic understanding of their needs and for an understanding of the Act. In some cases -- I had a report only two days ago -- there seems still to be a certain unfamiliarity with the Small Businesses Loans Act on the part of some bank managers.

For this reason we suggest that the banks themselves more vigorously promote these loans, be it a programme of education or constant reminder that there is a pool of $300 million, which expires in 1963 for this purpose, and that this lending pool has been barely tapped, and that the normal processing

of these loans on the basis of ability to pay and government guarantee will do much to encourage employment right at the local level, where it is so vital, and the movement of goods and materials right across this country will in turn, help our productive forces.

So, we feel the banks should explore every channel to encourage and inform small business of the availability of these loans. I have mentioned they might be advertised by the banks. Home-improvement loans were aggressively advertised, for a purpose, by the banks, who printed pamphlets, and they were displayed on bank counters all over the country. We think that something of this nature would do a great deal to encourage this lending programme in its early stages.

As far as trade organizations are concerned, we have campaigned from one end of this country to the other, in public meetings and bulletins, published all possible material, and in co-operation with the winter works programme, have endeavoured to inform not only the retail trade but all small businesses of the availability of these loans and the reasons why they should be utilized.

COMMISSIONER LEMAN: May I ask a question on this point? Your brief at page 19 gives me the impression that you are in favour of removing the 6 per cent legal ceiling on bank loans. What is not absolutely clear to me is whether you mean it should be removed for all areas of bank lending, or only for the particular area in which you are interested.

MR. GILBERT: We have made reference to the formation of an organization geared to extending loans to business for the formation of business, the improvement of business and the establishment of new business in amounts starting at $25,000. We have endeavoured to point out the real need that exists for financing inventories and receivables of small business in the field of between $5,000 and $25,000. For these reasons we have suggested that perhaps the banks and other financial institutions can be encouraged to fill this vacuum by granting these loans, properly secured by mortgages and other forms of collateral, and even at higher rates of interest to make such loans more attractive to the lenders. It is this category to which the brief refers.

COMMISSIONER LEMAN: Have you any views on whether the ceiling should be removed entirely and left to market forces?

MR. GILBERT: I am not clear on your question, sir.

COMMISSIONER LEMAN: Do you advocate removal of the 6 per cent ceiling on bank lending altogether?

Have you any views on whether that would be a good move or not?

MR. GILBERT: My answer would be that the fixed rate of bank interest should remain. You will observe that I do not suggest the rate be fixed at 6 per cent. This, of course, we know, must depend on the money market, and on the fluctuations in it, but the fixed rate for the general purposes of lending as specified in the Bank Act should, in our view, remain. The exception we are making is to develop some form of encouragement towards getting capital funds into this particular market to which we refer.

COMMISSIONER LEMAN: In your recommendation also about this matter of making loans more attractive to the lenders you refer to other financial institutions besides the banks. Which ones did you have in mind?

MR. GILBERT: The field we have in mind consists of trust companies, which are already into the lending field, and those lending institutions of the secondary variety such as finance companies, which might do more, in our view, in packaging financial deals and arrangements with a modest rate of interest which makes it possible for a businessman to use this lending facility. But, competition being what it is, we must always be conscious of the fact that certainly in the merchandising field the businessman must be aware of his ability to re-pay and also of the rate of interest that is affixed to his loan.

COMMISSIONER BROWN: Mr. Chairman, do you wish

to go straight on to the discussion of the brief of the Equitable Income Tax Foundation?

MR. GILBERT: If it is your wish, sir.

COMMISSIONER LEMAN: We might do that, Mr. Brown, because there is a reference to this in the other brief as well. In this connection we might refer to both briefs.

THE CHAIRMAN: Go ahead.

COMMISSIONER BROWN: I do not think we should go into this in any great detail, Mr. Gilbert. Although it is an interesting matter to discuss I would point out that a Royal Commission has been appointed to study this matter of taxation, and this submission is probably within its terms of reference. However, the problem of the flow of funds does come within our terms of reference, and there are a few points that we might discuss.

Have you any figures showing the relative growth in capital used in the different sectors of the retail business, including both equity and borrowed capital, and the amount of growth in credit unions?

MR. GILBERT: I missed the first part of your question, sir?

COMMISSIONER BROWN: Have you any figures showing the relative growth in amounts of capital used in the different sectors of the retail business, including in that both equity and borrowed capital, and the amount of capital in credit unions?

MR. GILBERT: For the purposes of this brief we do not, but with your permission I would like to give

you a written answer to this question.

COMMISSIONER BROWN: I think that would be helpful.

COMMISSIONER LEMAN: I think you meant all forms, and not just credit unions.

COMMISSIONER BROWN: Yes. Did I not make that clear?

MR. GILBERT: I want to make sure that I have the question correctly.

COMMISSIONER BROWN: Yes. When I had to repeat the question I am afraid I got lost. I was asking you if you had any figures to show the relative growths of capital used in the different sectors of the retail business, including the type that you represent, and co-operatives, and including in that capital both equity and borrowed funds.

MR. GILBERT: In the first question did you include credit unions?

COMMISSIONER BROWN: No. I did so by error, but I did not mean to. The main point of your thesis is that what has taken place is that there has been a greater growth in credit unions because of a tax factor.

MR. GILBERT: That is right.

COMMISSIONER BROWN: Further, you make the point that because of this increased capital co-operatives have been able to grow at a faster rate than private enterprise.

MR. GILBERT: Yes. I can appreciate the value of your question. Some of this information,

although sparsely, is contained in this recent publication of the Canadian Tax Foundation. It is not in such precise form that it would give you a total answer to your question, but I am sure we can find those figures for you.

COMMISSIONER BROWN: Secondly, can you show that any increased growth in co-operatives has been because of this capital factor? What are the other attractions that they have for their members and others?

MR. GILBERT: In the brief that we have presented we have pointed to this growth, and we have made numerous references to the recent growth of Canadian co-operatives; the appendix attached to our brief indicates the extent to which co-operative take-overs have taken place.

COMMISSIONER BROWN: Do you mean take-overs by co-operatives?

MR. GILBERT: Yes, of independent businesses and other businesses. This is quoted in our Schedule A which is entitled: "Recent Growth in Canadian Co-operatives" by R. Craig McIvor. It is a rather lengthy appendix.

COMMISSIONER BROWN: Yes, we have read that.

MR. GILBERT: I believe this appendix answers a part of your question.

COMMISSIONER BROWN: There is one other question that you can possibly answer as well. You make much of a desire to compete on an equal basis between the private retailers and the co-operatives. Do co-operatives have access to the small business loans?

MR. GILBERT: As far as I know. I would think they do as individual companies, but on this I am unable to give you a firm answer. My reply to this would be in the light of the developments that are taking place it is unlikely that very many co-operatives would need this kind of financing. They have access to funds through untaxed capital reserves which are declared as patronage dividends and which are borrowed from the members to expand their operations. This gives them a competitive advantage from the point of view of capital sources that are not available to ordinary types of business.

COMMISSIONER LEMAN: Given the rate of turn-over of capital in the typical retail operation, Mr. Gilbert, do you think you could translate for us the competitive advantage that the co-operative might have over a private retail establishment expressed as a percentage of gross price, for instance? If you back up the advantage you claim they have into their ability to cut prices, how much would it be?

MR. GILBERT: We doubt very much, with only a few exceptions, that the co-operative movement today is cutting prices to an appreciable extent below those of their competitors, or competitors in other businesses. This is one of the areas in which they get away, or are becoming far removed, from the original concept of co-operatives. They are trading for profit today just as any ordinary business is, and it is our contention that profits of all businesses should be taxed on an equal basis.

THE CHAIRMAN: Is there anything further?

MR. GILBERT: Mr. Chairman, on this question of reasons for the Commission concerning itself with this particular section of the brief, at page 3 we endeavour, in paragraphs 2 (i) and (ii), to put forward the reasons why we feel --

THE CHAIRMAN: Yes, we have read that and are familiar with it.

MR. GILBERT: The position of credit unions vis-a-vis banks is clearly relevant to the Commission's terms of reference, it would seem to us, and I say this with respect.

THE CHAIRMAN: Yes, we have read that.

Thank you very much, Mr. Gilbert, for your very interesting briefs and the discussion.

MR. GILBERT: Thank you very much, Mr. Chairman and members of the Commission.

THE CHAIRMAN: We shall now adjourn until Tuesday, October 16, at 9.15 A.M. in this room when we shall hear the submission of the Dominion Mortgage and Investment Association.

--- Adjournment.

Royal Commission on Banking and Finance

THE CANADIAN RETAIL FEDERATION

Hearings held at

OTTAWA

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SUBMISSION OF

THE CANADIAN RETAIL FEDERATION

TO

THE ROYAL COMMISSION ON BANKING AND FINANCE

July, 1962

SUMMARY OF CONTENTS

1. This brief is directed to an examination in depth of consumer credit in Canada, with particular emphasis on the retail credit granting function. It is concerned with the development and economic significance of consumer debt, as well as outlining in detail current practices in retail credit administration.

2. The Canadian retail trade is large, amorphous, and competitive. It is constantly changing as new merchandising forms or techniques emerge from the dynamics of the market place. Nevertheless, the traditional "independents" while transacting a decreasing percentage of retail sales, have increased their total dollar volume. The mail order houses continue to serve the more remote and isolated communities, offering in those areas not only a broad range of merchandise, but also consumer credit facilities that are competitive and comparable to those enjoyed by the city dweller. At the same time, retail cooperatives, aided by favorable tax legislation, have grown both in number and size. Some of them are now major business enterprises.

Within the retail structure, consumer credit facilities have evolved over the years. From the early "line of credit" at the store -- or the trading post of the fur and fish economies, more sophisticated and diversified credit plans have been developed to meet the varying requirements of the Canadian customer in 1962.

3. A very large amount of production takes place outside the market sector of our economy, but within the

approximately four million Canadian households. It consists of a number of services, comparable in many respects to services performed by a restaurant, laundry, nursery, or other business establishment. These services do not pass through the market place.

Retail credit is the "trade credit" of the household sector. It facilitates the process of purchasing, taking delivery of goods, and making payment. It contributes to the productivity of the household economy.

4. There has been a substantial growth in consumer credit in the decade ending in 1961, which paralleled a similar rise in the consumption of household durables. Higher family formation, larger families, rising personal disposable income per capita, created a strong demand for additional housing and a joint demand for durables. This was accompanied by a generally favourable economic climate over most of the decade -- a period of favourable income expectation on the part of consumers. In this atmosphere, the increased propensity to use credit to buy consumer durables was not only understandable, but economic common sense.

5. The secular growth of consumer debt has not been a danger to the economy. It has, in fact, contributed both to industrial productivity and to industrial employment.

6. In relation to the business cycle, consumer credit does not appear to be a major factor in producing turning points, but is a cumulative influence in either the rate of increase or decrease in business activity.

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6. In relation to the business cycle, consumer credit does not appear to be a major factor in producing turning points, but is a cumulative influence in either the rate of increase or decrease in business activity.

7. Any form of selective control over consumer credit in peacetime would be inimical to economic stability, increases in productivity and industrial employment. It would be highly discriminatory in its impact and run counter to the principle of consumer sovereignty.

8. The consumer should have as much information as is possible, within the practical limitations of retail administration, on the dollar cost of credit. Those legislative proposals that require the total cost constituents of credit service charges to be expressed as a simple interest rate are misleading, confusing and incorrect.

9. A committee of the Canadian Retail Federation is giving consideration to a uniform and practical approach to the problem of credit cost disclosure.

THE CANADIAN RETAIL TRADE STRUCTURE

1. Canadian retail trade is large, complex and intensely competitive. A dynamic business, it tends to react strongly whenever new merchandising forms or techniques are introduced -- as they are with some frequency. A constant struggle exists between its many segments, for within the same trading area each competes with all others in varying degree for the available volume of business.

2. The 1951 Census of Distribution showed some 151,000 separate retail establishments in the country -- taking no account of multiple ownerships, a factor which would tend to reduce the number. The 1961 Census is expected to reveal about 180,000 -- or approximately one retail establishment for every 100 Canadians. There is much variety in the trade and it is difficult to provide precise definitions by which to classify all of the country's retail distributors. Lines are frequently blurred as between different kinds of establishments, and descriptive terminology is often rather vague in its application.

3. Individual proprietorships and partnerships, with corporations, account for most retail volume. Nevertheless, retail co-operatives have continued to grow, both in number and size. With the competitive advantage of special tax dispensation, many of them have become major business enterprises, comparable in physical facilities and sales to the larger retail firms which bear their full share of the national tax burden. It is

estimated that in 1960, sales of retail co-ops amounted to $362,910,000. In the public sector, the military services provide various retail facilities for their people, such as Maple Leaf Services, which operates stores, canteens, etc. for the Canadian Army at home and abroad.

4. In the complex array of retail facilities available to the Canadian people, the mail order houses continue to occupy a rather unique position. Although mail order merchandising has been highly developed in both the United States and Western Europe, in this country it provides what can be reasonably described as certain desirable social benefits, as distinct from the profit motivation. While population growth, both natural increase and immigration, has speeded up in the post-war years, the population of our cities has risen more rapidly than in rural or semi-rural areas. Great sparsely settled land space still remains, with many remote and isolated settlements -- the heritage of earlier agricultural and resource development. For these sections of the Canadian community, the mail order catalogues offer amenities of life that would otherwise only be available with difficulty -- or indeed, not at all in any practical assessment. Similarly, in addition to the broad range of consumer goods they offer, the mail order houses make available consumer credit facilities to customers in remote areas, that are competitive and comparable to those which the city dweller enjoys. In this way, what could be called a "gap" in consumer credit availability has been filled.

5. Finally, the nationwide distribution of catalogues, with the prices of goods offered, fixed for up to six months, contributes not only to price stability, but also acts as a bench-mark in some areas where retail competition may be less than perfect.

6. Probably the most useful break-down of the trade is into the three groups represented by department stores, including mail order; chain stores; and independents. The Dominion Bureau of Statistics provides definitions for the first two. In general, it states that department stores carry a general line of both soft and hard goods, plus miscellaneous items; while chains are defined as having four or more stores in similar or related kinds of business. For all practical purposes, independents would pretty well consist of all the other forms of retailing.

7. At one time, Canadian retailing consisted entirely of what we would now describe as "independents". Various forms of mass merchandising have since emerged and inevitably the percentage of total retail sales achieved by the independent segment of the trade has been reduced. Parallel with this process, however, the country's total retail trade volume has greatly expanded -- e.g., from $3.4 billions in 1941 to $17 billions in 1961. The result has been that the independent sector, while being left with a decreasing percentage of total retail sales, has greatly expanded its total dollar volume. Concurrently, the numbers of independent merchants have substantially increased. It is probably true that this situation has been possible

and that Canada has had room for such a variety in retailing mainly because of the expansion in her economy over the years.

8. The Dominion Bureau of Statistics quite properly includes in its statistics on retail distribution, all forms of that sector of the economy. Retail statistics, however, are somewhat confused by the inclusion of many groups which we might describe as "non-store trades". For example, automotive products tend to exceed 20% of total retail sales, and there are a number of other kinds of retail distribution which might be grouped under the non-store heading. These would include garages and filling stations, establishments selling boats and associated supplies, fuel dealers, ice and implement dealers, and some other types of establishments.

9. What we customarily refer to as the "store trades" consists of total retail trade minus the above-mentioned categories. For example, on the basis of 1960 retail sales amounting to about $16.5 billions, some $5 billion was done by the non-store trades, leaving about $11.5 billions to the store trades. This total in turn was broken down into the following approximate figures: $1.5 billion done by department stores including mail orders; $3.5 billion done by chain stores of all types including food; and $6.5 billion done by independent stores.

10. Since approximately 1950, the most significant development in Canadian retailing has been the growth of the shopping centre concept -- a reflection

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11. The Canadian department store companies have been later in the development of their suburban branches than has been the case in the United States, but this development now appears to be in full swing, and department store branches in shopping centres are now becoming commonplace. The so-called minimum service store has spread into Canada after a beginning in the United States dating back some years. So far, branches of these chains are located in suburban areas, and normally the lack of restriction on store hours is an important factor to them. Shopping hours of 10:00 a.m. to 10:00 p.m., six days a week, are the rule. This type of store attempts to project a low-price image, render relatively few services, and seek a mass market. Some of these stores tend to operate on a concession basis -- that is, the owners of the various departments are other than the owners of the store. There are exceptions to this, however, and at least one large organization operates on a basis of self-owned departments. A variant of this is the closed-door type. These so far are few in number and sell membership cards

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by which entrance is gained. They tend to restrict their membership cards to members of the armed forces, government employees, and similar categories of people.

12. The shopping centre and more latterly the minimum service store have both had a considerable impact on the structure and techniques of the retail trade, and we look for a good deal of evolution in the near future as the competitive struggle within the trade continues.

13. As can be seen, retailing in Canada is neither static in development, nor constant in image. It is amorphous yet dynamic -- and, above all, competitive. Consequently, Canadian retailing does not lend itself to easy generalization about its relation to the financial and monetary systems. Rather than examining the many points at which retailing impinges on the monetary mechanism, this brief will be directed to a study in depth of what the Canadian Retail Federation believes is the single most important element -- consumer credit in its relation to economic policy; and the motivation and execution of the credit granting function by the retailer.

14. Credit has always been associated with retailing. In Canada's earlier largely agricultural society, even in the days of the fur and fish economy, the merchant supplied goods on credit and might well be paid in produce. Credit "at the store" was more than a convenience to many at this stage in our history -- it was frequently a necessity. In earlier urban Canada the charge account was used mainly by the financially

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15. Our society has changed drastically over the years and retail credit usage and credit forms have changed as well. Different types of instalment credit have appeared and the forms of these continue to evolve to suit changing situations. The charge account, bearing no credit charge to the customer, is still widely popular as a form of short-term retail credit. The remaining kinds of accounts, while differing in many respects, provide in common a longer time for payment and a charge to the credit user for the longer term accommodation.

16. If one were to attribute a single motive to the merchant in credit granting, it would presumably be the basic one of obtaining patronage. The provision of credit in some form is expected by the public, although in some branches of the trade -- such as food stores -- circumstances have changed and credit has been largely eliminated. Aside from the important consideration that the public expects to obtain credit from many forms of retailing, merchants provide credit services to promote the sale of their wares. It is generally accepted in the trade that a customer is likely to patronize a store to a greater extent when a credit account exists. Competition, too, is a factor and credit is so generally associated with so many kinds of stores that an individual firm's withdrawal from credit granting would be considered to provide a very potent advantage to its competitors.

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II

CONSUMER DEBT IN CANADA:
ITS DEVELOPMENT & ECONOMIC SIGNIFICANCE

17. Recently The Economist wrote,

> " One should begin by stating basic principles, for it is these that are most easily disregarded...."(Feb.3, 1962, p. 395).

Taking counsel from The Economist our first comment on this question will be a reminder of a simple but often forgotten point. It is that a very large amount of production takes place outside the market sector of our economy. In addition to business enterprises (sole proprietorship, partnerships, the 125,000 odd corporations and co-operatives) there are about 4 million family households ("consumer enterprises") in Canada in which production takes place daily. Household production consists of a large number of services, comparable in many respects to services performed by a restaurant, laundry, nursery, or other business establishment. All these household services are, however, consumed within the establishment and do not pass through the market place.

18. Since this output is not sold it is difficult to measure its value. It does not enter, therefore, into the official statistics of Gross National Product, which, by necessity, relate almost exclusively to the market sector of the economy. It is noteworthy, however, that assuming one household worker per family, the household labour force as of the start of 1962 was

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19. What leads then to the development of "consumer" indebtedness? Essentially it arises from the same causes as does business indebtedness. Retail credit is the "trade credit" of the household sector. It facilitates the processes of purchasing, taking delivery of goods, and making payment. The buyer does not have to plan how much cash will be necessary and carry large amounts on major purchasing expeditions, wait for change when shopping or for cash refunds when returning merchandise. Much credit is extended as part of the process of "bringing the store to the buyer". It would not be feasible for the housewife to place the large number of telephone orders or mail orders for goods she has not actually seen if she knew she could not return them. Like businessmen, many housewives understandably are reluctant to pay for goods before

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they are certain that they are what they want. Also charge accounts enable deliveries to be made without the necessity for an occupant to remain at home as is the case with C.O.D. purchases. The monthly statement provides the customer with a permanent record of all purchases, returns and payments. The retail charge account adds flexibility to the amount of monthly spending. In brief, it contributes to the efficiency with which household operations can be performed -- a basic reason for its use to finance a proportion of the household's asset requirements.

20. Credit provided by retailers in instalment accounts and revolving credit accounts is extended for periods up to 24 or 36 months. These accounts are especially helpful for the purchase of major items, such as furniture and appliances. The large variety of fixed assets applicable to the production of household products and their high productivity creates a large demand for credit of this kind.

21. The purchase of a so-called consumer durable is an investment which produces a benefit for the household. Individuals, of course, are not accustomed to making explicit calculations of the benefit. To illustrate the similarity, however, between the reasoning behind a business loan and the extension of consumer credit, we can envisage a rational, calculating consumer doing arithmetic of the following type. He is contemplatin purchase of a television set (or an automatic washer, automobile, or other consumer durable). He knows the

cash price of the goods. He then calculates for each year of the expected life of the good the money value of the services it renders to him. (An estimate of this can in some cases be obtained from the rental cost of the item or from the cost of purchasing the services from a business establishment; e.g., the cost of a movie or of public transportation.) From these annual "revenue" figures he must subtract repair and maintenance costs and depreciation allowances and add, in the last year, scrap or trade-in value. He can then equate the present net value of this future stream of services to the cash price of the good and calculate the implicit benefit of purchasing the good. He then takes into account the cost of borrowing money, and makes comparable computations to the businessman to arrive at a "net profit" or "net loss" -- on which his decision is made. (A distinction which, however, is important and to which we will return later, is that the businessman's revenue stream in future years provides the cash flow out of which the loan and its cost is repaid, whereas the consumer indebtedness must be repaid out of cash flows from other sources.)

22. Most consumers do not, and many cannot make such "rational" calculations. Doubtless, however, in many cases the benefit from consumer durables is very high and such a calculation would not change the consumer's intentions. Many consumers account for their instalment debt by the simple explanation that without it they would be unable to buy many important things. A survey of consumers conducted in the United

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States in the mid-1950's found this to be the "overwhelmingly frequent argument in favour of instalment buying."[2] This condition together with the high benefit attributable to investment in durable goods provides a rational basis for the incurrance of household indebtedness.

23. As indicated above, the net benefit from the use of consumer credit can be realized in more than one way. It may take the form of increased consumption of the service that the durable provides (e.g., television); or it may cause a reduction in costs, so that other consumption or saving can be increased. The result may be free time to do other work inside or outside the household, in either case the result increasing the total output of goods and services. Or the benefit may be taken up in the form of leisure. In a society that espouses consumer sovereignty, it is the sovereign's prerogative to choose how the benefit will be taken. If the result is greater consumption or leisure, it does not reflect against the institution of credit.

24. Attributing consumer indebtedness to the desire for efficiency in household operation runs counter to some popular thinking on the subject. There is a tendency (presumably on the part of non-borrowers) to

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[2] George Katona, "Attitudes Towards Saving and Borrowing," Consumer Instalment Credit, Pt. II, Volume I (Conference on Regulation, National Bureau of Economic Research on behalf of the Board of Governors of the Federal Reserve System: Washington, 1957), p. 455.

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associate household indebtedness with irresponsible spending, prodigality, penury, or financial irrationality. As one writer has stated:

> " There exists, and always has existed, a bias against debt itself. It is found in the ancient Judaic law, which forbade lending; in the Catholic-medieval concepts of usury; in the Elizabethan drama as a pound of flesh; in the windy structures of Polonius, who argues 'neither a borrower nor a lender be'; and indeed in virtually every pre-industrial society known.
>
> The anti-consumer-debt bias in our time may well be a holdover from very rational beliefs of the late eighteenth, nineteenth, and early twentieth centuries in England and the United States, when low-level consumption and high-level savings were indispensable to the growth of capital whereby consumption was equated with the sin of indulgence." [3]

25. To this cause of the anti-household-debt bias we would add two others. One is tendency to equate "consumer" debt with "non-productive" debt. Some who

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[3] Sidney E. Rolfe, "Instalment Credit: the $28 billion question." Harvard Business Review, July-August, 1956, p. 51.

hold this viewpoint apparently reason that consumer debt means excessive allocation of resources to the household sector of the economy to the detriment of the business or public sectors. Such arguments while they have relevance to the growth of the capacity of the business sector of the economy to produce larger quantities of consumer goods in future periods of time and to provision of social capital rather than individual household capital, must be tempered by recognition of the strong time-preference of many consumers for durable goods now instead of later because of the high yield of services such goods provide the household.

26. The other cause is a tendency to presume that the existence of debt means the absence of assets, other than encumbered items, and even negative net worth. While this can be so in individual cases, some debtors have sizable holdings of assets. As Table 4 (p.23) -- a table which will be explained later in this brief -- shows, 25 per cent of the non-farm families in Canada in 1959 in the 30-39 age group held liquid assets amounting to 100 per cent and over of their consumer debt. Many of these debtors could be debt free. That they are not is a matter of their own choice. Some individuals see a need for holding larger amounts of liquid assets as a reserve for contingencies and borrow to make major purchases while keeping their emergency fund intact. Some use instalment credit as a medium for forced savings. Others may have low liquidity requirements, or would draw upon their non-liquid assets or increase their indebtedness in case of

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need. As with business enterprises, the existence of debt does not mean an absence of net worth. Credit standards being what they are, this condition does not easily arise.

27. We do not wish to deny that access to credit cannot lead to over-buying. Some consumers are financially immature. They have to learn the hard way. Retailers try not to extend credit to them, as it may wind up as involuntary philanthropy. But of course some mistakes are made. However, it does not follow that all consumers who have credit troubles are in trouble as a result of their access to credit. The cause can be elsewhere. Sometimes it is the lender's guidance which lays the foundation for the development of a habit of solvency.

28. With this background in mind, let us now turn to the actual growth of consumer credit in Canada. Although some data are available since 1939, it is only beginning in 1951 that a comparable series for some of the main components of consumer indebtedness can be put together. Table 1 (p.20) shows the growth since 1951 of retail dealer and finance company credit extended to consumers, together with selected loans extended mainly to individuals for non-business purposes by certain financial institutions. The total excludes credit extended for goods and services (such as restaurant and hotel credit cards, oil companies' credit cards, medical and dental credit) by sources for which

data are not generally available.[4] These statistics indicate the growth which has taken place in the last decade. The unevenness in the rate of growth reflects the alternating periods of expansion and recession through which the economy has passed. While seasonally-adjusted monthly or quarterly data would show better the movement of consumer credit during the business cycle, the only seasonally-adjusted series generally available is that published in the Canadian Statistical Review by the Dominion Bureau of Statistics for total finance company and retail dealer credit extended to consumers. The growth of chartered bank personal loans and credit union loans relative to the other sources of credit limits the usefulness of the former total as an indicator of total consumer credit outstanding. The consumer undoubtedly plans his purchases out of the total pool of credit available to him. We have tried therefore in Table 1 (p.20) to give an indication of the size of this total.

29. We have distinguished in Table 1 between personal loans by chartered banks, Quebec savings banks, and credit unions which are not secured by assets other than household property, and loans by chartered banks

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[4] Data on balances outstanding on oil companies' credit cards have been available for recent years. The balance outstanding at the end of 1961 was $47 million and the changes during the years for which data are available are, in millions of dollars: 1957, 6; 1958, 5; 1959, 5; 1960, 3; and 1961, 4.

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and life insurance companies against financial savings already accumulated by the consumer. In case of default of the loan in the latter case, a financial asset exists to repay the loan and no loss is suffered by the lender. This is not to say, of course, that the loss of the asset by the consumer does not have adverse consequences on his financial position.

30. Table 1 excludes mortgages since these are secured by title to a building or other property. Moreover, in this case, the borrower may have the option of living in the property himself and paying the mortgage interest and principal out of wage or other income or renting the property to others and paying the mortgage out of rental income. In most cases, the liability of a mortgage is offset by the possession of a potential revenue-earning asset. This is not true for other personal loans which must be repaid out of the future earning power of the borrower himself.

31. From the viewpoint of indicating the effect of credit extended to persons upon sales of members of the Canadian Retail Federation, it would be desirable to separate automobile financing from financing of other purchases. The figures for "other retail" in Table 1 exclude the charge accounts of motor vehicle dealers since this type of credit is extended mainly to business firms. Conditional sales agreements with consumers are, however, included. These amounted to about $18 million at the end of 1961.[5] Of the total $760 million

[5] D.B.S., Canadian Statistical Review, February 1962, Table 77.

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[5] D.B.S., Canadian Statistical Review, February 1962

of balances outstanding on conditional sales agreements held by instalment finance companies at the end of 1961, $560 million was for passenger cars.[6] When an individual obtains a loan from a financial institution, however, he may use it either for automobile or for other purposes (except for home improvement loans), making the separation of automobile financing difficult.

32. The growth of consumer credit reflects a number of factors. However, the demand for credit at the end of World War II was low in part because of the unavailability of consumer goods and the large stock of liquid assets accumulated during the War by consumers, some of which was undoubtedly used to pay off existing indebtedness. This stock of liquid assets also undoubtedly financed much of the durable goods expenditures in the immediate post-war period. In the 1950's consumer credit outstanding grew in response to rising incomes, economic prosperity, family formation and the resultant demand for consumer durables. Changes in the Bank Act together with several innovations in the marketing of consumer credit enabled credit to grow in response to this demand. Chart 1 (see Appendix B) indicates the way in which the main totals of the items shown in Table 1 have grown while Charts 2 (see Appendix B) and 3 (see Appendix B) show the growth in personal disposable income, purchases of consumer durables, and families. (For convenience, a ratio scale has been used in the chart so that equal vertical distances on the chart represent the

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[6] Bank of Canada Statistical Summary, February 1962, p.107.

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[illegible]

same percentage increase).

33. Chart 2 (see Appendix B) shows a comparison that is frequently made but which may be quite misleading. In Chart 2 (see Appendix B) the growth of consumer credit is compared with the growth of personal disposable income. When a family borrows, however, it is frequently a newly-formed family which is borrowing against future earnings in order to obtain the durable goods today to provide the future stream of household services necessary to the effective functioning of a modern household. A more appropriate comparison would be the present value of the future stream of earnings in relation to the debt outstanding. For newly-formed families, although the present income level is low, the time period before retirement of the head of the family is long and one would expect, therefore, that a substantial debt would be incurred early in the life-cycle of the family, refinanced many times, retirement of the debt begun as the children enter the labour force, with the debt fully repaid before the head of the family retires from full-time employment.[7] As the proportion of new families increases, as will be likely in the latter part of the 1960's, one would expect a rapid increase in the consumer debt exceeding the growth in personal income. Such a situation should not be a cause for alarm as long as the proper ratio of debt to future earnings power is maintained and the estimated future earnings

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[7] An interesting elaboration of this argument appears in Alain Enthoven, "Instalment Credit and Prosperity," American Economic Review, XLVII (Dec., 1957), 913-929.

are realized.

34. Failure to realize the expected future earnings may result from several factors. The individual may over-estimate his ability to earn or repay debt out of his earnings. The institution granting the credit, if conscientious, should be able to help the individual to assess realistically his commitments in relation to his earning power. Unforeseen events such as sickness or death of the head of the family may leave a family with a heavy debt burden and no income. Ideally, it should be possible to insure against such contingencies. The individual family may also be affected by changes in general economic conditions resulting in unemployment. The head of a new family is usually young and lacks seniority; he therefore is vulnerable to recessions. Monetary-fiscal and other policies designed to lessen unemployment will mitigate this possible effect of consumer indebtedness.

35. Some cross-section data are available for early 1959 on the incomes, liquid assets, and indebtedness of non-farm families in Canada[8] which tie in with the time series data of Table 1 and which are

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[8] D.B.S. Publication 13-514. _Income, Liquid Assets, and Indebtedness of Non-Farm Families in Canada, 1958_. (Ottawa: Queen's Printer, 1960). The data shown in Tables 3-7 which are taken from this publication exclude unattached individuals (persons living by themselves or rooming in a household where they are not related to other household members).

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consistent with the above hypotheses about consumer indebtedness, incomes, assets, and the family life cycle. The data unfortunately do not indicate the number of years the family has been in existence or the number of children. They do, however, give the age of the family life cycle. (Total "consumer debt" as defined in this table by D.B.S. is closely comparable to the total "selected consumer credit" in row 10 of Table 1.)

36. It may be noted that a richer body of data exists in the United States and many extensive studies have been made. Because of the similarity of the patterns revealed in Tables 2-5 and patterns revealed by comparable studies by the Survey Research Center of the University of Michigan, it is most likely that the findings of research studies in the United States on household behaviour are applicable to Canada. Some U.S. studies have, for example, given special attention to the relation between durable-goods expenditures, financial saving, and other variables.

> " Strong evidence now exists that to a large extent, purchase of durables is a substitute for financial saving .... these studies find purchases of durable goods related to a variety of socio-economic characteristics, particularly age, income change, size of consumer unit, and various expectations ...such expenditures are found to be influenced ... by a variety of demographic and attitudinal variables, and are found to be sticky downward and flexible up-

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"ward with respect to changes in income." [9]

> " In a comprehensive study of the factors influencing the composition of the 'capital account' of the household (essentially financial assets, durables, business capital), (it was) concluded that households tend to maintain some sort of balance in their capital accounts both between assets yielding direct service and financial assets, and between liquid funds and liabilities." [10]

" Other studies in the United States indicate:

> "...the tendency for younger families to be heavy purchasers of durable goods even though they have to dissave to do so, whereas older families with the necessary assets make relatively few durable good purchases." [11]

These and other results on the effect of family composition

> "...have brought into focus the importance of a family life-cycle variable, a variable

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[9] Studies by Irwin Friend and Robert Jones, L.R. Klein, and E.S. Maynes cited by Robert Ferber, "Research on Household Behaviour", <u>American Economic Review</u>, LII (March, 1962), 46.

[10] A study by H. H. Watts and James Tobin cited by Ferber, <u>op. cit.</u>, 41.

[11] Studies by Janet Fisher cited by Ferber, <u>op. cit.</u> 34.

"which would reflect the simultaneous influence of a number of socio-economic characteristics.[12]

38. With these points in mind, we may now look at the Canadian data. Table 2 (p.21) indicates a rising debt level of families until the head of the family is in the 40-49 age group. After this point, debt begins to decline with over half the families with heads 50 and over having no debt. That this reflects in part the family life cycle rather than being only a reflection of an income effect is indicated by Table 3 (p.22). In Table 3,(p.22) where families in the same income group are compared, the same pattern of debt rising until the head is in the 40-49 age group and then declining is evident.

39. As was pointed out above, the levels of indebtedness must also be judged in relation to liquid asset holdings. Table 4 (p.23) shows that the holdings of liquid assets is at least as large as "consumer debt" levels for many families; for example, in the 30-39 age group, this is true for 25 per cent of the families. The pattern may be summarized as follows:[13]

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[12] Studies by S. G. Barton, D. L. Miller, Franco Modigliani and Albert Ando, Dorothy Brady, and John Lansing and James Morgan, cited by Ferber, op. cit., 34-35.

[13] D.B.S. Publication 13-514. Tables 19, 37, and 50.

Age of head	No liquid assets	No consumer debt	Average Liquid assets	Average Consumer Debt
	per cent		dollars	
29 and under	32	27	528	453
30-39	28	34	975	470
40-49	30	35	1,232	554
50-64	25	52	1, 847	326
65 and over	22	75	4,509	321

The same pattern is generally evident when families within the same 1958 income groups are compared.[14]

	INCOME GROUP $3,000-4,999		INCOME GROUP $5,000-6,999	
Age of head	Average Liquid Assets	Average Consumer debt	Average Liquid Assets	Average Consumer Debt
29 and under	404	424	880	576
30-39	487	435	1,013	543
40-49	601	436	1,347	637
50-64	1,139	418	1,866	381
65 and over	4,451	150	5,447	407

[14] Ibid.

40. The above discussion has been in terms of the "consumer debt" component of total selected indebtedness shown in Table 1 (p.20). The distribution of total non-mortgage debt by income size is somewhat similar to that of consumer debt. Families with higher incomes have a larger quantity of financial assets which may be used to secure loans from banks or life insurance companies. Thus, as Table 5 (p.24) shows, total debt indicates a greater concentration among upper income families, than does consumer debt.

41. No data are readily available on regional distribution of consumer indebtedness. As Table 6 (p.25) shows, however, there are significant regional differences in the size distribution of income and it is to be expected that these would be reflected in regional differences in levels of consumer credit outstanding. Because of regional differences in the availability of credit unions, the types of credit used by consumers may also vary regionally.

TABLE I

SELECTED CONSUMER CREDIT AND OTHER LOANS TO INDIVIDUALS*, CANADA 1951-1961

(millions of dollars)

		Balance Outstanding at Dec. 31 1951	Increase or Decrease (-) in Balance Outstanding										Balance Outstanding at Dec. 31, 1961
			1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	
1.	Department Stores	78	63	26	19	41	17	18	20	32	50	33	401
2.	Other retail dealers	328	83	46	42	25	30	10	15	22	-5	13	605
3.	Instalment finance companies	186	187	143	-24	107	157	24	-12	38	22	-68	760
4.	Small loan companies	114	34	28	39	64	77	6	39	83	65	34	583
5.	Total Retail dealer and finance company credit extended to consumers	706	367	103	76	237	281	58	62	175	132	12	2,349
6.	Chartered bank unsecured personal loans**	204	38	66	43	90	-6	-14	132	166	138	173	1,030
7.	Quebec savings banks loans not secured by mortgages	4	2	2	-1	1	3	2	-1	1	1	3	17
8.	Credit union loans not secured by mortgages	76	18	35	22	23	52	32	62	77	28	(28)	(453)
9.	Sub-total (items 6-8)	284	58	103	64	114	49	20	193	244	167	(204)	(1,500)
10.	Total selected consumer credit (items 5 + 9)	990	425	346	140	351	330	78	255	419	299	(216)	(3,849)
11.	Chartered bank personal loans secured by marketable bonds and stocks	226	32	11	-16	86	-26	-56	30	-5	4	50	336
12.	Chartered bank government guaranteed home improvement loans	-	-	-	-	24	14	10	10	2	-4	10	66
13.	Life insurance company policy loans	199	14	12	15	10	20	25	10	18	21	16	360
14.	Sub-total (items 11-13)	425	46	23	-1	120	8	-21	50	15	21	76	762
15.	TOTAL	1,415	471	369	139	471	338	57	305	434	320	(292)	(4,611)

*Excludes mortgages

**Includes loans secured by household property and assets other than marketable bonds and stocks.

SOURCE: Bank of Canada Statistical Summary, Feb. 1962, p. 109 and Supplement, 1958, p. 87; Annual Report of the Governor of the Bank of Canada, 1961, p. 75; and D.B.S. Canadian Statistical Review, 1959 Supplement, p. 123.

NOTE: Figures in parentheses are estimates for 1961.

TABLE 2

Percentage Distribution of Consumer Debt* of Non-Farm Families Cross-Classified by Age of Head of Family, Canada, Spring 1959

	AGE OF HEAD				
Consumer Debt:	29 and under	30 - 39	40 - 49	50 - 64	65 and over
			per cent		
No consumer debt	27	34	35	52	75
Under $250	25	25	25	22	15
$250 - $499	15	12	12	8	4
$500 - $999	17	15	12	8	3
$1,000 - $1,999	12	9	10	7	1
$2,000 - $4,999	3	4	4	2	1
$5,000 and over	-	1	2	1	1
TOTAL	100	100	100	100	100
			dollars		
Average debt	453	470	554	326	321
Median debt	229	156	147	0	0
Average debt - debtors only	621	714	855	685	1,274

*Includes charge account and instalment debt, debts to small loan companies, credit unions, and chartered bank personal loans except home improvement loans and loans secured by marketable bonds and stocks

Note: Components may not add exactly to totals because of rounding.

SOURCE: D.B.S. Publication 13-514, Table 37.

TABLE 3

Percentage Distribution of Families by Age of Head, by Consumer Debt, Spring, 1959, and by Income, 1958, Canada

	Income $3,000 - $4,999				
	AGE OF HEAD				
Consumer Debt:	29 and under	30 - 39	40 - 49	50 - 64	65 and over
	per cent				
No consumer debt	26	34	36	50	70
Under $250	25	26	26	22	19
$250 - $499	15	12	12	11	5
$500 - $999	21	16	13	7	3
$1,000 - $1,999	11	9	9	6	1
$2,000 - $4,999	2	3	4	2	2
$5,000 and over	-	1	1	2	-
TOTAL	100	100	100	100	100
	dollars				
Average debt	424	435	436	418	150
Median debt	238	152	135	0	0
Average debt - debtors only	571	662	677	839	489
	Income $5,000 - $6,999				
No consumer debt	26	30	35	49	67
Under $250	23	23	20	21	15
$250 - $499	12	12	13	9	2
$500 - $999	15	17	14	8	7
$1,000 - $1,999	18	15	11	8	5
$2,000 - $4,999	6	3	6	5	4
$5,000 and over	-	1	1	-	1
TOTAL	100	100	100	100	100
	dollars				
Average debt	576	543	637	381	407
Median debt	262	224	189	14	0
Average debt - debtors only	781	772	974	745	1,225

Note: Components may not add exactly to totals because of rounding.

SOURCE: D.B.S. Publication 13-514, Table 37

TABLE 4

Percentage Distribution of Non-Farm Families by Age of Head and by Ratio of Consumer Debt to Liquid Assets*, Canada, Spring 1959.

Ratio of Liquid Assets to Consumer Debt	AGE OF HEAD: 29 and Under	30 - 39	40 - 49	50 - 64	65 and Over
		per cent			
No liquid assets, no consumer debt	7	8	9	10	14
Some liquid assets, no consumer debt	20	27	26	42	60
No liquid assets, some consumer debt	26	20	21	15	8
Ratio under 100%	18	20	22	19	13
Ratio 100% and over	30	25	22	13	5
TOTAL	100	100	100	100	100

*Includes deposits with chartered banks and other financial institutions, and government of Canada and other bonds, but excludes cash. Some of these bonds may be pledged as collateral against loans not included in the "consumer debt" total.

Note: Components may not add exactly to totals because of rounding.

SOURCE: D.B.S. publication, 13-514, Table 50.

TABLE 5

Percentage Distribution of Consumer Debt and Total Debt* of Non-Farm Families by Income Groups, Canada

1958 Income:	Consumer Debt Spring 1959	Total Debt* Spring 1959
	per cent	
Under $1,000	1	2
$1,000 - 1,999	6	4
2,000 - 2,999	9	7
3,000 - 3,999	19	14
4,000 - 4,999	16	12
5,000 - 6,999	24	20
7,000 - 9,999	19	21
10,000 and over	6	20
TOTAL	100	100

*Excludes mortgage debt but is slightly more comprehensive than the total selected debt in Table 1.

Note: Components may not add exactly to totals because of rounding.

SOURCE: D.B.S. Publication, 13-514, Table 55.

TABLE 6

Percentage Distribution of Non-Farm Families by Income Groups
and by Regions, Canada, 1958

Income:	Atlantic Provinces	Quebec	Ontario	Prairie Provinces	British Columbia	Canada
			per cent			
Under $1,000	8	2	2	4	2	3
$1,000 - 1,999	21	9	6	12	10	10
2,000 - 2,999	16	16	10	12	11	13
3,000 - 3,999	20	21	17	17	17	18
4,000 - 4,999	14	17	20	18	17	18
5,000 - 6,999	12	20	24	23	25	22
7,000 - 9,999	7	9	14	9	14	11
10,000 and over	2	6	7	4	4	6
TOTAL	100	100	100	100	100	100
			dollars			
Average income	3,622	4,874	5,419	4,622	4,945	5,096
Median income	3,257	4,066	4,717	4,220	4,514	4,548

Note: Components may not add exactly to totals because of rounding.

SOURCE: D.B.S. Publication 13-514, Tables 3 and 8.

III

INSTALMENT DEBT AND DURABLE GOODS PURCHASES

42. The preceding section dealt with the broad outlines of the growth of total consumer credit and suggested some relationship between this growth and the growth in families, income, and spending on consumer durables. In this section we would like to explore the changes in various types of credit and spending on durable goods more carefully.

43. As was explained earlier, limitations of data force us to confine most our remarks to the period 1951-61. This, however, is a period in which consumer debt has grown rapidly and has become a subject of some consideration among some observers of the economic system.

44. Over the decade consumer debt and its main components, as shown in table 1 (p.20) changed as follows:

TABLE 7

Growth in Selected Consumer Credit

Canada, 1951 - 1961

	1951	1961	Change	Per cent Change
	(millions of dollars)			
Department Store Credit	78	401	323	414
Other Retail Credit	328	605	277	84
Total Retail Credit	406	1,006	600	148
Unsecured bank and finance company loans	584	2,843	2,259	387
Secured bank and insurance company loans	425	762	337	79
TOTAL	1,415	4,611	3,196	226

SOURCE: Table 1.

The total of these items of consumer debt increased by 226%. Total retail credit increased by 148% due largely to a high rate of growth (414%) in department store credit. Loans by instalment finance and small loan companies, unsecured personal loans by banks and credit unions increased by 387%, similar to the increase in department store credit and by relatively more than the growth in total debt. Chartered bank loans secured by marketable stocks and bonds, home improvement loans, and life insurance company policy loans increased by 79%, or relatively slowly, as did other retail credit. As a result of the different rates of growth, retail credit declined from 29% of total consumer debt in 1951 to 22% in 1961.

45. Of total credit supplied by retailers, instalment credit outstanding increased more rapidly than credit outstanding in charge accounts. From data published by the Dominion Bureau of Statistics, a rough breakdown of the two components can be made which will give some indication of the growth of instalment credit. Over the decade charge account credit outstanding rose by 55% compared to a rise of 328% in instalment credit. In 1951 charge accounts were roughly two-thirds of total retail credit. In 1961 the proportion was about two-fifths. Of the growth in retail credit over the decade less than one-quarter was in charge accounts.

TABLE 8

Retail Dealer Credit Outstanding with Consumers, by Type of Credit, Canada, 1951, 1961.

	1951	1961	Change	Per Cent Change
	(millions of dollars)			
Charge Accounts	268*	415*	147	55
Instalment Credit	138*	591*	453	328
TOTAL	406	1,006	600	148

* Based on estimates of department store charge accounts amounting to $36 million in 1951 and $80 million in 1961.

SOURCE: D.B.S., Canadian Statistical Review.

46. The use of charge accounts is associated in large measure with purchases of non-durable goods (and some minor durables). Personal expenditures on non-durable goods (excluding electricity and gas for household operations) rose from $7.6 billion in 1951 to $11.6 billion in 1961 or by 53%. At the same time charge accounts of retail dealers rose by an estimated 55%.

47. In general retail charge accounts are intended to provide credit for short periods, usually one month or less. Other types of consumer credit are used to provide financing for longer periods. Some bank loans are payable on demand, but are not often originated with the expectation that they will be extinguished within a month. Taken together it is this longer, non-charge account type of debt that has grown rapidly in recent years. It has accounted for 95% of the growth in consumer debt during the last decade.

48. Non-charge account debt arises largely from large purchases, mostly major durable goods. Some of it represents the refunding of charge accounts, but such refunding is often made necessary by the purchase of major durables. Loans to consolidate many small debts, or to pay for medical services are secondary in importance.

49. Purchases of durable goods by consumer, as indicated in Chart 4 (see Appendix B) rose from $1.5 billion in 1951 to $2.7 billion in 1961, an increase of 80%. A major component of this aggregate is, however

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passenger automobile sales for personal use. Credit for such purposes is not included in the "retail credit" shown in Table 8 (p.28). Personal expenditure on new automobiles, used automobiles (net), and house trailers increased by about 110% in this period while expenditure on other durables increased by only about 65%. This latter figure compares with an increase of about 240% in instalment credit extended by retail dealers.[1] The growth in non-charge account debt appears therefore to be the result of a combination of (1) the rise in the aggregate value of durable goods purchases, (2) an increase in the propensity to use credit to make such purchases and (3) more recent expansion in the use of such credit for other purposes.

50. Basic to the growth in demand for durables was the rise in personal disposable income per person

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[1] Some of the financing of non-automobile durable goods purchases is by conditional sales contracts held by sales finance companies or by loans obtained from banks, credit unions, small loan companies, or life insurance companies. The balances outstanding on conditional sales contracts on non-automobile purchases owing to sales finance companies rose from $45 million in 1951 to $200 million in 1961, i.e. by 350%. Unsecured loans from small loan companies, banks and credit unions quadrupled in this period to about $2,100 million. As was pointed out above loans secured by marketable bonds and stocks, home improvement loans, and life insurance company policy loans rose by about 80%.

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and in the number of families. Per person income increased by a third over the decade. The number of familie rose from 3.35 million in 1951 to 4.13 million in 1961, an increase of 23%.[2] That families also increased in size is suggested by the fact that annual births rose by 25%, or more than the rate of growth in families, and the per cent of births which were third and subsequent children rose too.[3] Population and income changes created a strong demand for additional housing and a joint demand for durables. New housing of the desired type and cost could be provided largely in the suburbs, access to which was greatly enhanced by the ownership of one or more cars. Household labour-saving devices were highly attractive as the supply of labour to the household was limited by the undoubling of households, entry of married women into the labour force, a scarcity of domestics while the longer journey to work partially, if not fully, offset shorter working hours outside the home. Larger families meanwhile meant more work. Not surprisingly expenditures on durables kept pace with the increase in personal disposable income.

51. The increased propensity to use credit to buy consumer durables is attributable to a number of causes. In general the feasibility of borrowings for any spending entity is governed by the prospective level and certainty of its future income. It seems

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[2] CMHC, Canadian Housing Statistics, Quarter 3, 1959, 23, and 1961, 43.

[3] CMHC, op. cit., 1961, 41.

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reasonable to state that favourable expectations concerning both these conditions prevailed over a large proportion of the decade under review for a very large proportion of the population. As was stated in the Federal Reserve Board study <u>Consumer Instalment Credit</u>:[4]

> " In the period since World War II, consumer willingness to incur debt has been influenced by favourable income prospects. When incomes rise fairly steadily and people are optimistic about continuance of the rise, consumers are likely to consider future instalment payments, including finance charges, as less of a burden than full cash outlay at the time of purchase. When income is expected to rise, today's income dollar is worth more to the consumer than the dollar that must be repaid next year."

and as Katona has written:[5]

> " There is no other group which goes into debt so frequently as those who anticipate income increases ......People who have experienced income increases, and aspire for and confidently expect further increases, hurry to change their standard of living."

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[4] Part I, Volume 1, Growth and Import, 16.

[5] George Katona in National Industrial Conference Board, <u>The Economics of Consumer Credit</u> (New York, NICB, Studies in Business Economics, #50, 1955) 46 and cited by Rolfe, <u>op. cit.</u>, 54.

52. As industrial wage rates continued to mount year by year, employed workers presumably became increasingly confident of further increases. For increasing numbers, collective bargaining agreements provided a contractual basis for such expectations. Rising wage rates not only must generate expectations for further increases, but also create confidence that rates will not fall below existing levels. Workers conceivably become more willing to assume debt for this reason. Moreover as the 1950's progressed, the 1930's receded further into the past; more and more workers reaching the age of acquisition of durables had little or no direct knowledge of the depression. Their own experience was with inflation -- a process which benefits debtors. Meanwhile unemployment insurance (extended to seasonal workers during the period), access to paid employment for many housewives, and the spread of prepaid medical plans, tended to diminish the vulnerability of the budget to fixed payment on indebtedness.

53. Conditions of supply of consumer finance also contributed to the rise in use of instalment credit. Department stores now offer greater facilities for deferred payments as noted in Section VIII. Average repayment terms on retail paper purchased by finance companies show some increases since data was first published in 1957.[6]

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IV

IS THE SECULAR GROWTH OF CONSUMER DEBT A DANGER ?

54. That the growth of consumer credit is a matter of concern to some is indicated by the following statement made by a former Governor of the Bank of Canada.[1]

> " There is....a form of dis-saving, represented especially by consumer credit, which amounts to mortgaging one's future in order to consume today at a higher rate than one's present income can finance. To some degree and in some circumstances such action is unavoidable. It is clear, however, that there has been a very large and rapid expansion of consumer credit in this country since the War, and this increase came out of the savings of other people which otherwise would have been available for financing Canadian development under Canadian ownership and control.
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> We used to think we were more conservative in this regard than the Americans, that we did not engage in high pressure selling techniques and were not susceptible to the urgings of those who would have us live beyond our means. Evidently the salesmen

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"have been very successful in overcoming our sales resistance in this field. The rate of increase in consumer debt in this country in recent years, and indeed ever since the Second World War, has been greater than the rate of increase in the United States, and the amount of consumer debt in this country now represents approximately the same proportion of personal income after tax as in the United States.

Any programme for increasing Canadian Savings, especially the personal savings of Canadians, and ensuring that these savings are put to uses which will be of most benefit to the nation as well as most rewarding to their owners, would be strengthened by a changed attitude towards consumer debt and consumer credit."

55. We do not, as we indicated earlier, share this position. We hold that investment by the consumer in household durable goods contributes to the productivity of the household economy, an important but often over-looked sector of the economy. Indeed, as one writer has aptly expressed it:[2]

" The household can be viewed as a decision-making organization engaged in much the same activities as a business firm. From

[2] Ferber, op.cit., p.49.

"this perspective, the household becomes a separate organization that receives income and other money receipts and that disperses this money in accordance with certain criteria. Entering into these criteria are the wants and desires of different household members, the structure of the household and the interpersonal relationships existing among the different family members, all subject to various economic restraints. The explanation of consumer behaviour then becomes a matter of identifying and measuring the relative importance of factors that enter into the decision process."

56. This viewpoint has also been expressed by the Radcliffe Committee in the United Kingdom in commenting on hire purchase as a source of consumer credit:[3]

" A large amount of short-term and medium term credit becomes available to private consumers and to a much smaller extent to business concerns, through hire purchase or credit sales .....The significance of hire purchase in the financial structure of the economy is thus that it is a convenient source of medium-term credit on fixed terms

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[3] Report of the Committee on the Working of the Monetary System (London: Her Majesty's Stationery Office, 1959), Cmnd. 827, pages 72-74.

"for the purchase of equipment, where the equipment itself can provide adequate security for the loan and the loan can be paid off by regular instalments.

The purchaser is free to employ his personal credit in other directions if he wishes, a circumstance of particular importance to business users. His sole obligation, after making the initial deposit, is to meet his regular contractual payments; these can be as large a proportion of his income as he thinks fit. While he escapes the necessity of saving in advance of his purchasers, and draws on the savings of others to finance his investment, the act of repayment restores those savings for other users, and there remains in his hands a stock of goods that may be presumed to make as real a contribution to the amenities of life as any other form of investment."

57. We would agree, however, that misallocation of resources can occur if credit is extended for this purpose on a basis which is not commensurate with the benefit from such investment. Since the benefit is, however, a subjective evaluation on the part of the consumer, we must -- in general -- assume that provided the consumer fully understands the cost of the credit he is extended, he is making a productive investment.

58. While we hold this general position, we admit that many individuals undoubtedly do not make rational

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calculations in comparing benefits on investment in durable goods with the cost of money. Moreover, many consumers are not proficient in making such calculations. We are trying, however, to state a general position on the role of consumer durables in the economy and upon debt as a method of financing their purchase. Education and more information on the dollar cost of credit services to the consumer should remove some of the misuses of consumer credit.

59. This does not mean, however, that the many abuses of consumer credit are to be taken lightly. We argue, however, that steps taken to correct abuses should not affect the rational use of credit by intelligent consumers to purchase durable goods to produce a future stream of services within the household.

60. We have indicated earlier that we do not feel that there is any great significance in the ratio of consumer indebtedness to personal disposable income. It has been suggested that there are critical upper limits to this ratio.[4] Such an argument implicitly assumes that consumer debt is distributed more or less evenly throughout the personal sector with the result that very large numbers of consumers are expected to have to retrench on spending at roughly the same time. But all consumers are not in debt at once and those who are do not all increase their debt together. Borrowing varies over the family's life cycle. "Debt

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[4] S. E. Harris and H. M. Groves cited by Enthoven, op cit., p. 914

rotates through the population".[5]

61. It can be shown how in a period in which income is increasing, as in the postwar period, and when debt at the start of the period is abnormally low (below its equilibrium level), as at the end of World War II,

> "...then the relative rate of growth of debt will always exceed that of income, converging on the latter asymptotically from above",

and to conclude that

> "...it is not correct to suppose that a progression in which the relative rate of growth of debt exceeds that of income must be temporary and of short duration or must overcome consumers' budgets with re-payments".[6]

62. A principal explanation for the high rate of growth in instalment debt outstanding since the end of the war is "the abnormally low ratio of debt to income" at the start of the period.[7] This is reflected in the change in the ratio of consumer debt (as shown in Chart 2, Appendix B) to personal disposable income in Canada of 9.6% in 1951 to 17.1% in 1961.

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[5] *Ibid.*, p. 921

[6] *Ibid.*, p. 927

[7] Ibid., p. 927

63. A question that is sometimes raised is what constitutes a maximum safe debt limit for consumer credit? In general we believe that safe limits on borrowing are established by the conduct of sensible borrowers and by retailers who provide credit only to sound credit risks. It has been suggested however, that a good margin should be preserved between "volume of indebtedness and the volume that would dangerously expose the country to deflation during recessions".[8]

64. The following has been advanced as a "roughly correct criterion" for establishing a dangerous level of indebtedness. It is when debt repayments become so large that in even a mild recession they are likely to produce an excess of planned saving over planned investment that is so large that the imbalance cannot be redressed rather quickly either by speeding the application of easy money or by fiscal policy.[9] This criterion, however, applies to other forms of private debt as well as to consumer debt. In fact it probably applies to other forms with more force since consumer debt is relatively short in term. In the short-run, at least, when incomes decline inflexible debt repayment requirements may not cause the curtailment of other expenditures because liquid assets can be drawn down, other financial saving can be reduced

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[8] Sumner Slichter, contribution to "The Economics of Eisenhower; a Symposium", Review of Economic Statistics, November 1957, 370.

[9] Ibid. 369

(e.g. by borrowing for new purchases instead of paying cash) and by refinancing the debt. Many consumer debtors, judging by the high coverage of their debts by liquid assets, may well be in a far better position to maintain their spending in the face of a decline in income than many businesses are.

65. It is worth noting that for many households the proportion of assets that can safely be debt-financed is relatively higher than for many businesses. It is because the income of the head of the household is often more predictable than that of the business. Besides businesses take on debt with much longer maturity.

66. So far we have considered only concerns evoked by the long-term rise in consumer debt. It would be a mistake however, to say that the secular growth in debt has produced only concern. There has been perhaps a tendency to emphasize consumer investment as the cause of growth to the point where consumption has been neglected. Ruth Mack, a leading student of consumer expenditure writes as follows:[10]

> " I hold that one cannot adequately explain the most notable of the trends in America -- the growth in real consumption and its high level throughout -- without recognizing the unusual force of the drive to consume and its effect upon productive

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" effort."

She submits that explanations for the rapid growth in output in America which are commonly attributed to such causes as rich natural resources, the talents and special skills of the people, the large domestic market, "seem to assume a zest for work and a willingness to take chances which themselves need explanation." She finds part of this explanation in the

> "...unusual interest in consumer goods that has characterized the American scene. Income.....is a function of consumption, via consumption standards, just as truly as consumption is a function of income."

Among her suggestions for maintaining and strengthening this source of growth is "healthy credit facilities for consumers."[11]

67. Two other benefits to the economy as a whole of the growth of consumer credit may be cited. One is that the accumulation of capital (including consumer durables) in the household may have revived interest in property ownership and has made it more widespread. This may contribute to revitalizing attitudes towards capitalism and strengthening the foundations of ur free enterprise economy.[12]

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[11] Ibid., 68

[12] This point is discussed further by Moses Abramovitz in Board of Governors of the Federal Reserve System, Consumer Instalment Credit (Washington, 1957), pp. 246-253.

68. Of great importance also to the economy is the effect of this growth in consumer durables upon industrial productivity. Consumer durable industries in Canada have benefitted in two related ways. The significant increase in the size of the durable goods market in Canada has undoubtedly enabled producers to achieve economies of scale. Moreover, in Canada durable goods producers also produce industrial machinery and equipment. To the extent that the demands for producers and consumers durables have different cycles, the growth in the consumer market has allowed fluctuations in the demand for producers durables to be at least partially offset by the demand for consumer durables.

69. Finally, to these points must be added the fact that consumer credit provides an outlet for savings. Surely thrift loses its virtue if it is the cause of unemployment. Concerns over consumer credit were they to lead to measures which would curb its growth could be dually harmful, restricting the growth of both household productivity and industrial employment. Indeed, adequate consumer credit facilities operating freely within the disciplines of the market place, are essential to stable economic growth and a rising level of employment.

V

CONSUMER CREDIT AND THE BUSINESS CYCLE

70. We have argued that the growth of consumer credit, although great is not a cause for undue concern. The tendency for it to increase at a greater rate than personal disposable income appears to be satisfactorily explained when we take into account the family life cycle in which each year a number of new families in the early stages of household formation enter the consumer credit market while a smaller number[1] leaves the market by paying off its debt after entering the later stages of the family life cycle.[2]

71. When we turn to the problem of cyclical stability we must look at the cyclical behaviour of personal expenditure on consumer durable goods. As Chart 4 (see Appendix B) indicates, the growth in durable goods expenditures has been uneven. Indeed in 1954, 1957 and 1960-61 expenditures either failed to increase significantly or decreased slightly. This has been

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[1] The number of families entering the credit market for the first time will usually be greater than the number withdrawing when the total number of families is increasing. See Chart 3.

[2] Enthoven, op.cit., This point of view has also been accepted in a Staff Report on Employment, Growth, and Price Levels prepared for the Joint Economic Committee of the Congress of the United States. (December, 1959), pp. 385-387.

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both a reflection of the three periods of slowdown in the general rate of economic activity which we have experienced in the last decade and a cause of it. Since most durable goods expenditures can easily be postponed for many months, such expenditures may be quite sensitive to changes in the growth of personal income. Moreover, when income fails to increase or when income decreases, the burden of repayments on existing debt reduces the amount of income free for new expenditures. Whether an attempt by businessmen to offset this short-run income effect by easing credit terms in the downswing and to tighten them in the upswing would introduce more stability in the rate of growth of durable goods spending is questionable. In part it depends on the responsiveness of the consumer to changes in terms and on his recognition that terms had, in fact, changed. Undoubtedly an easing of credit terms at a time that income is increasing may intensify the short-term variability of personal spending on consumer durables. It is noteworthy that after the last three recessions, a substantial increase in total finance company and retail dealer credit extended to consumers (seasonally adjusted)[3] did not occur until about one year after the general upswing in economic activity began.

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[3] D.B.S. Canadian Statistical Review, Feb. 1962, P. S-9.

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goods spending; the "other" component increasing at a relatively steady rate of increase.[4] In Canada, as Chart 4 (see Appendix B) indicates both components have been in phase. That is, the slowdown in consumer spending on durables in Canada appears to have been spread over all items in the group whereas in the United States automobile purchases have borne the brunt of the cyclical adjustments in consumer spending. Although the cyclical swings of the two components in Canada have been in harmony, automobile expenditures have more than doubled in the period, while "other" expenditures have increased by only two-thirds.

73. We would conclude our remarks on the effect of consumer credit on economic stability by quoting from a review of various studies of this topic in the United States:

> " A consideration of the various effects of consumer credit on stability leads to the conclusion that it may for various reasons be a significant factor in the cumulative propulsion of the economy in one direction or the other but that it is not likely to be a major factor in producing turning points."[5]

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[4] Staff Report on Employment, Growth and Price Levels, pp. 385-390.

[5] W. L. Smith, "Consumer Instalment Credit", American Economic Review, XLVII (Dec. 1957), 972.

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[4] Staff Report on Employment, Growth and Price Levels, pp. 365-370.

[5] [illegible] Economic Review, XLVII (Dec. 1957), 972.

This is not to say, however, that if expenditures on durable goods are sensitive to changes in the rate of growth of personal income, that such expenditures do not contribute something to turning points. The review goes on to conclude that:

> "...it is by no means clear that the destabilizing effects of such credit are so powerful or of such great strategic importance that it should, on this ground alone, be specially singled out for control."[6]

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[6] Ibid., 973

VI

CHANGES IN THE COST OF CONSUMER CREDIT AND THE DEMAND FOR CREDIT

74. A question arises as to how households react to changes in the total cost to them of consumer credit since it may be through this mechanism rather than through changes in the quantity of credit available at a fixed price that changes in general monetary conditions are reflected to the consumer. In the past it appears that most consumers have ignored such changes. Thus, in this sector of the economy, the price system has not worked efficiently.

75. There are two requirements for it to do so. First, the buyer of credit must be quoted the price in such a way that the true magnitude of a change is immediately obvious to him. In the case of purchase of goods on credit, this requires that both the cash price and the time payment price be known to the purchaser. The cash price must be a true cash price; that is, the purchaser must be able either to buy the goods for cash at that price or obtain credit on the quoted time payment price. Moreover, the credit terms must be quoted in such a manner that both changes through time and differences in prices of credit be evident to the buyer.

76. It should be emphasized that what is relevant is the total dollar cost to the consumer of the credit he obtains. It is no more relevant to his decision for him to know how much of this total cost represents

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the cost of funds and how much represents costs of handling the account and how much, if any, is a profit to the credit-granting institution than it is for him to know when he buys, say, a refrigerator, how much the retailer paid for the goods and what the overhead, other expenses, and profit are.

77. The second requirement is that the consumer, knowing that changes in the cost of credit have occurred, be sensitive to them. We suggest that generally consumers are sensitive to changes in the prices of all goods and services that they buy, including credit, provided that the price change is sufficient to affect his buying plans. If the implicit benefit of future services derived from the purchase of a durable good by a household is high, then to induce the family to postpone purchase from a period of excess demand to one of slack demand, the cost of credit must be very high in the boom period and low in the downswing of the cycle. Undoubtedly, however, changes in the cost of credit would have some effect on marginal purchases.

78. Various factors mitigate, however, against changing the costs of credit through time as a device to try to produce changes in the inter-temporal purchase of durable goods. Principal among these is that a change in the cost of credit to a specific user may produce changes in the costs of funds for other purposes. Wide amplitudes in the movements of bond rates or bank loan rates would cause problems for corporate and government financing. For this reason, fluctuating costs of funds as a device for influencing consumer expenditures

on durable goods would not seem to be acceptable. One cannot treat the price of one type of credit in isolation from all others in a free-market economy and in this case it may be that the effect on other money markets would be undesirable.

79. We would suggest, however, that disclosure of the total dollar cost to the consumer of credit within the limits of practical retail administration be adopted as an aid both in helping the consumer make more rational decisions and as a device which may have some slight benefits in making the use of consumer credit contribute more towards economic stability.

VII

SELECTIVE CONTROLS OVER CONSUMER CREDIT ?

80. A main concern of economic policy may well be to create a fiscal and monetary environment conducive to steady and adequate growth. Such a concern presupposes that there is some "proper" division of the productive resources of an economy among various broad categories: The production of business capital goods to be used in producing consumer goods and services for sale in future periods of time, the production of consumer capital goods (durables) to be used in producing consumer services to be used within the household in future periods of time, the production of social capital to provide community services in future periods of time, and the production of goods and services for present consumption either domestically or abroad. If it could be shown that there is some allocation of resources among these four broad alternatives that could provide a growth rate whic would result in full employment without inflation and without disruptive balance of payments difficulties, and this growth rate will not result from the free interplay of market forces, a case for governmental control or influence over resource allocation can be made.

81. This control can be either through general money market influences upon the structure of inetest rates or through controls on particular types of financial transactions, such as the specification of

minimum down payments or maximum repayment periods on consumer credit. The former are general monetary controls; the latter are specific controls.

82. We need also to distinguish between the use of such controls to smooth out the growth path by reducing fluctuations in economic activity. In the preceding section we have suggested that the change in interest rates required to influence the cyclical behaviour of consumers is likely to be too large to produce the desired result without upsetting other parts of the capital market. We suggest that the use of selective controls for this purpose is likely to be too blunt a weapon, except in periods of emergency such as war, and its use is likely to amplify rather than reduce the now moderate cyclical fluctuations in consumer behaviour.

83. Moreover, we suggest that if selective credit controls are to be used to combat inflation, they would seem to have greater possibility for success if applied to a large volatile sector of spending rather than a relatively small one. The absolute amount of changes in spending on consumer durables that can take place is small by comparison with the absolute amount of the changes that can occur in business non-residential fixed capital formation. In 1956 when central bank moral suasion was used in an attempt to cut down the growth of consumer credit, business investment in new non-residential construction, and new machinery and equipment increased by $1.4 billion, and the value of the physical change in business inventories

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was $0.7 billion. Expenditures on major durables rose by a mere $0.2 billion. In fact <u>total</u> spending on major durables during the year was $2.1 billion, the amount of the <u>increase</u> in business fixed investment and inventories. We are not aware of any suggestions that business investment be subjected to selective credit controls.

84. Turning to the question of the long-run allocation of resources we would question first of all that there exists any satisfactory basis for interfering with the allocation of resources brought about by the price system. As one professional economist has expressed it:

> " I doubt if our knowledge of the relevant relationships is great enough to provide guidance for the effective administration of controls designed for this purpose. In fact, there are probably many 'proper' relationships between consumption and investment depending upon the attendant circumstances."[1]

85. That is to say, consumer credit controls run counter to the principle of consumer sovereignty. If the consumer is to be sovereign he should be permitted to allocate his resources as he chooses, not only between alternatives at one point in time, but over time as well. If the consumer is to be sovereign it is other sectors that must adapt to his preferences.

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Selective controls on business investment would hamper the business sector in adapting to what it thinks are the emerging preferences of the consumer. However, controls on consumer credit inhibit the expression of the very preferences themselves.

86. Moreover, consumer credit controls operate to stabilize the whole of economic activity by stabilizing a part. Policies of this kind introduce rigidity into the economic system. They achieve their effect by restricting adjustments to changing demands within the economy. While general monetary controls which operate through the money supply are not as pervasive as they might be they do not have the objection of singling out a particular component of demand to inhibit its movement.

87. We suggest that consumer credit should not be restricted because the household sector is widely under-capitalized. This is partly because a variety of consumer capital goods have come on the market at prices which many households could afford only in the post-war period. It is also partly attributable to a time lag in the development of a wide range of consumer financing facilities, to meet the specific requirements of individual households, in turn probably caused partly by moral antipathy to the institution of consumer credit -- a heritage of 19th century attitudes towards saving. When we have passed through this stage consumer credit will grow less rapidly. When consumer investment becomes only marginally profitable to borrowers and lenders it will likely become more

responsive to general monetary conditions.

88. We would also point out that consumer credit control is highly discriminatory. It discriminates between purchasers of consumer durables who do and do not require credit. From what has been said earlier there is no valid economic or moral basis for such discrimination. It also discriminates against investment by consumers in favour of investment by businesses and governments. What is the basis for imposing controls on down payment requirements and amortization periods on consumer credit without similarly imposing controls on the corresponding terms of corporate bond issues? Even if parallel restrictions were placed upon the terms of bond issues (e.g. raising minimum requirements for covering funded debt by fixed or net tangible assets; setting the maximum terms of bonds at 10 years and requiring 100% sinking funds) there would still be discrimination against consumer investment. Credit is the consumer's only means of external financing whereas corporations can issue shares.

89. Some of the talk of peacetime controls on consumer credit dates from the large expansion of such credit in the U.S. in 1955. In no small measure this was attributable to a coincidence between an expansion in auto sales and a relaxation of credit terms. There are however, upper limits to the feasible lengths of time for which credit can be extended on the security of durable goods. Moreover, some rashness and mis-judgments are to be expected in a relatively new but fast growing industry. If selective control were to be

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placed upon each area in which lending has been excessive at one time or another there would be controls on stock market loans (not just moral suasion), controls on loans to wholesalers, inventory loans, and controls on bond issues by paper companies and uranium companies.

90. As a final point we quote studies of the question of selective control on consumer credit made in the United Kingdom and in the United States. The Radcliffe Committee commented that hire purchase controls

> "...are open to easy avoidance (as distinct from evasion) which grows rapidly if the controls are maintained for any appreciable time, and we could not recommend any attempt at a general control of trade credit which would seem to be the only logical way of stopping such avoidance....apart from special cases, (the authorities) should be reluctant to use (hire purchase) controls for operating on the general economic situation."[2]

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[2] Report of the Committee on the Working of the Monetary System op. cit., p. 183

[3] Report of the Commission on Money and Credit, Money and Credit; Their Influence on Jobs, Prices and Growth (Englewood Cliffs,; Prentice-Hall, 1961), p. 74.

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"The difficulty of efficient administration of selective controls over consumer credit is a major argument against them. Past experience shows that evasion is a constant problem. A minimum ratio of down payments on some durable goods, such as automobiles, have been by-passed by charging ostensible trade-in allowances. The growth of leasing could permit consumers to acquire cars on terms which might differ significantly from those imposed by the credit authorities."

92. In conclusion, we are of the opinion that the allocation of resources brought about by an efficiently-functioning price system should not be interfered with except in cases of national emergency.

VIII

RETAIL CREDIT PRACTICES

93. In the post-war years, retail credit facilities have become more varied, more available, and more adapted to the needs of particular customers. The appearance of substantial discretionary income in large groups of the population -- a potential for saving or spending among many alternatives, has exercised its influence. Changing status symbols, the advent of family shopping, shifts in the periodicity of income flows, have had their impact on retail credit practices. Even some services, particularly travel, are being sold on credit. In a sense, the wide-spread use of consumer credit has become both a form of budgetary discipline within the family, and a socially acceptable way of twentieth century living -- a contribution to the household economy.

94. To meet consumer demands, many forms of retail credit granting have evolved. Here it may be most helpful to outline the principal aspect of current practices.

TYPES OF ACCOUNTS

95. Charge Account -- a convenient method to make one monthly payment to cover day-to-day purchases.

96. Advantages

(a) A permanent record of all purchases, returns and payments on a monthly statement.

(b) Only one cheque each month.

(c) No need to carry large sums of money or to wait for

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(b) Only one cheque each month.

(c) No need to carry large sums of money or to wait for

change when shopping.

(d) Deliveries can be made without necessity to remain at home as for C.O.D. purchases.

(e) Facilitates return of merchandise by credit to account and eliminates cash refunds.

97. Instalment Account -- This type of account, usually identified with periodic purchases of large items, is known under a variety of titles, such as - Contract, Budget, Deferred Payment, Monthly Payment, etc. Essentially it is an account with a specific number of months during which payments are due, with a Carrying or Service Charge, added to the balance at the outset. Many of these Contracts require a Down Payment varying between 10% and 15%. The amount of the monthly payment is arrived at by adding the Carrying Charge to the amount financed (amount of purchase less down payment) and dividing by the number of months the contract has to run. Contracts vary in length of time from 12 to 36 months, and are usually secured under a Conditional Sales Agreement.

98. Revolving Credit or Charge with Option Terms -- Also known by several names such as Continuous Charge, Option Charge, Budget Charge, All Purpose, etc., is a continuous type of account on which credit is extended on the basis of an amount or balance rather than identified with a particular purchase of merchandise. It enables the holder to make everyday purchases by the use of a Credit Card, on the basis of a Master Agreement or Contract signed when the account is opened.

It permits the customer to pay the balance in full within 30 days with no charge, or to make payments over a number of months with Service Charge added.

99. The amount of monthly payment may depend on the maximum balance or monthly balance, depending on the individual plan. The Service Charge is generally calculated on monthly balance (and is shown in dollars on Customer's statement by most responsible retailers).

OPENING ACCOUNTS

100. Application -- is usually completed as follows:

Name (surname and initial)
Address and how long there
Previous address or addresses and how long at each
Wife's first name
Residence and business telephones
Owner, tenant or roomer
Employer, position and for how long
Income (wages and salaries)
Other income
Wife's employer, position and income
Former employment
Name and address of bank
Personal references (nearest relative as one)
Record of other store accounts or loans

101. Agreement -- is signed at the time of application. The wording varies as to the type of account. For a Charge Account, the customer agrees to pay in full each month. For an Instalment Account, a conditional

sales agreement stipulates that title to the merchandise remains with the stores until fully paid.

102. Authorizing new accounts -- suitable identification is requested from the customer and noted. The application is then checked for accuracy and supplementary information is obtained from Credit Bureaux[1] or other reporting agencies and direct investigation of facts reported by the customer. The paying habits of the customer are checked and the employment information is verified. While the capacity to pay and net worth of the applicant are important, basically the acceptable credit risk must have a good record of meeting his financial obligations as they become due -- a fact that must be verified through the investigation indicated above. The credit authorizer will make a decision based on his experience and available information regarding the particular applicant as detailed above.

103. Up to 20% of applications are declined, either because of poor credit records or, in the judgment of the credit authorizer, it would be in the best interests of both the store and the customer not to extend credit at that time.

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CONTROLLING CREDIT ACCOUNTS

104. With an instalment account, control can be firm. The balance of the account is controlled by the good judgment of the authorizer. Each new purchase to the account is carefully considered and the record is reviewed to avoid having the customer obligated beyond his estimated ability to pay. If some time has elapsed since the account was opened, a further clearance may be obtained from the Credit Bureau to ascertain the amount of outstanding debts at other stores.

105. With a charge Account or Revolving Credit Account, it is the usual practice to issue an identification card or plate that permits the customer to make smaller purchases without the necessity of reference to the Credit Department. Until an account however, is thoroughly established or if the degree of risk warrants more control, a "restricted" identification card is used, so that each individual purchase must be authorized. A "purchase record" slip is used to record authorized additions to the account, and this form is destroyed when the actual salesbill is processed.

106. Each account naturally must have a "Credit Limit". It is customary to arrange a mutually satisfactory limit at the time the account is opened. This forms the basis for any future discussions as to the amount that may be purchased. Whenever the "Credit Limit" is changed, proper notification is given to the customer to avoid any misunderstanding.

107. Any derogatory information received from the Credit Bureaux or other sources is indexed. This prevents

CONTROLLING CREDIT ACCOUNTS

104. With an instalment account, control can be firm. The balance of the account is controlled by the good judgment of the authorizer. Each new purchase to the account is carefully considered and the record is reviewed to avoid having the customer obligated beyond his estimated ability to pay. If some time has elapsed since the account was opened, a further clearance may be obtained from the Credit Buréau to ascertain the amount of outstanding debts at other stores.

105. With a charge Account or Revolving Credit Account, it is the usual practice to issue an identification card or plate that permits the customer to make smaller purchases without the necessity of reference to the Credit Department. Until an account however, is thoroughly established or if the degree of risk warrants more control, a "restricted" identification card is used, so that each individual purchase must be authorized. A "purchase record" slip is used to record authorized additions to the account, and this form is destroyed when the actual salesbill is processed

106. Each account naturally must have a "Credit Limit". It is customary to arrange a mutually satisfactory limit at the time the account is opened. This forms the basis for any future discussions as to th amount that may be purchased. Whenever the "Credit Limit" is changed, proper notification is given to the customer to avoid any misunderstanding.

107. Any derogatory information received from the Credit Bureaux or other sources is indexed. This preven

new accounts being opened for undesirable risks. An "automatic signal service" is used by the bureaux, to inform a store that already has an account opened, that subsequent unsatisfactory experience has been recorded by another store.

BILLING ACCOUNTS

108. With instalment accounts, the customer's payment book can be revised with each purchase or this can be accomplished by mailing a monthly statement whenever additions are authorized. With a Charge or Revolving Credit account, all transactions -- both debits and credits -- are accumulated and billed once a month. The media may be microfilmed before mailing with the statement. In this way, the customer has complete details for all transactions on the account. In smaller stores it may be preferable to describe each purchase on the statement and file the media, rather than mailing it to the customer.

COLLECTIONS

109. It is axiomatic in the retail trade that an account well opened is not likely to be a collection problem. Not only must the retailer have a complete application and a thorough check of all information, generally with a clearance through the Credit Bureau, but also a clear understanding as to the terms of the contract. The great majority of customers are honest and are not apt willingly to obligate themselves beyond their ability to pay.

110. If terms are properly defined, the average

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customer only requires a routine reminder if payment is overdue. For the first two months that a balance is past due, impersonal notices are mailed. Some stores place stickers on statements or use similar means to call attention to overdue payments in the early stages of delinquency.

111. After an amount is more than two months overdue, a more personal method must be used for collecting. The most effective tool is the telephone. This is a quick and direct approach that will usually give an immediate answer as to why payment has not been received. If the customer is experiencing some financial difficulty, a satisfactory arrangement can normally be arranged. It is not always possible or practical to telephone each delinquent customer and in such cases form letters with increasing firmness are generally used.

112. Only when an assumption is made, based on the relevant data, that the customer is able to pay, but unwilling to do so, is the account referred to a solicitor or collection agency. It is natural that the store would wish to avoid this additional expense. At the same time, the customer's record is brought up to date at the Credit Bureau, so that new accounts will not be opened by other stores.

113. A strict collection policy and prompt follow-up of overdue accounts, together with careful authorizing, reduces bad debt losses to a minimum. When a credit department is well organized, bad debts are only a small percentage of total credit sales. Losses are not usually

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due to poor investigation at the time the account is opened or to inadequate control of purchases, but rather to unavoidable changes in the customer's circumstances, such as ill health.

114. In such cases, it is general practice to discuss with the customer some feasible basis of payment, usually extending the terms, in an effort to assist the customer in meeting obligations over a difficult period. This method of reaching an amicable arrangement with the customer is much preferred by retail stores, rather than recourse to any methods of forcing settlement.

115. Normally a charge is made for credit over 30 days; this may take the form of delinquency charge on regular Charge accounts, or a regular service charge on accounts which are paid in instalments. On the latter accounts, charges are usually predetermined and made known to the customer in a schedule at the time the credit is extended. The charge made for deferred payments is based on a complex of cost factors. These costs inherent in credit vary with wage levels, extent of service and convenience rendered to the cusomter and interest rates.

SOME ASPECTS OF RETAIL CREDIT ADMINISTRATION

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credit granting under varying economic conditions.

117. For example, in periods of relatively tight money, some retailers may have limitations placed on their ability to finance consumer credit receivables. The degree of restriction will depend, in large measure, on the diversity of financing sources. When monetary restraint is exercised, most directly through the banking system, those retailers pre-eminently dependent on this source of funds, will experience the greater difficulty in expanding their credit sales. In any case, while general monetary restraint may be uneven in its impact, all retailers offering consumer credit facilities will be affected to some extent. Under such circumstances, they will operate within the frame-work of their own financing availability, by extending credit to those credit applicants who meet a higher standard of qualification.

118. In the event of an economic depression, or a serious decline in earning power of wage earners, retailers do take steps to restrict credit to those who appear as marginal risks. (This is true on a regional as well as on a national basis.) It is accomplished by requiring larger down payments and obtaining more detailed information on the individuals' financial position.

119. In a period of lower and unstable income, there is usually an increase in the demand for credit from good credit risks who choose to keep a cash reserve. For this reason, the total amount of credit extended during such periods may not decline to any substantial

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120. Because borrowing costs to the retailer are not the principal determining factor in the total cost of providing credit services, revision in charges to the consumer would only be made when there are relatively wide swings in interest rates, reinforced by the belief that the new structure would be maintained over a reasonable length of time.

121. Over the past ten years, changes in money rates to the retailer have not exhibited sufficient variation to shift in this context alone, total credit service costs to the consumer. The major costs in the total credit package -- particularly wages, have risen continuously during this period. On the other hand, competition between retailers for credit business, as a medium for selling goods, has also rapidly intensified over these years, exerting a downward pressure on the price to the consumer of this service.

122. Most responsible retailers would agree that the purchaser of credit services should know the price of them -- in the same way the price of particular merchandise is provided. Many retailers already supply their customers with this information by showing on the appropriate documents, in addition to the cash price of the merchandise, the price of credit services supplied over a stated period of time. This practice is growing, although there are undoubtedly a fringe of credit grantors who could do much more in this direction.

123. At the present time, provincial governments have varying legislation applying to the offer and use

of consumer credit. There is, however, a still unresolved area of jurisdiction on consumer credit legislation as between the provinces and the federal government. Irrespective of any jurisdictional questions, it would appear desirable that there be as wide a use as possible of a standard procedure for presenting information to the customer of the price of credit services being bought. Such a uniform approach should not only provide true price information to the consumer, but should also be administratively practical within the credit operations of the retailer.

124. Unfortunately, the various bills on the subject introduced in provincial legislatures or in parliament, do not achieve these objectives, however well-intentioned their sponsors may have been. Most of them would give false and misleading impressions to the purchasers of credit services, while at the same time creating completely unworkable operating requirements for the credit grantor. (see Appendix A) In particular, those bills that require the total cost constituents of credit service charges -- wages, supplies, equipment, the price of money, etc. -- to be expressed as a simple interest rate, are misleading, confusing, incorrect and unworkable.

125. In fact, they are mischievous nonsense. Nor should the individual retailer be asked to disclose any one of his cost constituents for credit, since the same competitive situation exists as if he or his supplier were asked to give information on particular costs of an item of merchandise.

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126. Within the various types of consumer credit plans -- instalment, revolving credit, etc., there are particular administrative problems even in providing what is meaningful and truly informative to the customer -- the price of credit. In an effort to design some uniform and useful approach to this, a committee of the Canadian Retail Federation is giving this problem most careful consideration.

amount of an individual sale and the length of time allowed for repayment. The cost of handling items of small value almost invariably will be proportionately greater than for items of larger value. Further than this, the credit plans that have been developed to meet customer requirements and convenience involve so many variables that it is not possible or correct to convert the charge for these services to a simple annual interest rate.

It is true that there are formulae (at least six variations) which may be used to calculate the approximate annual rate of charge on an individual dollar transaction if it stands alone and has set and non-variable conditions or terms. This condition however rarely exists on credit extended in the sale of merchandise and, at the time that a particular transaction takes place, the circumstances that will apply through the period until the merchandise is fully paid for are not known and cannot be fully documented. Under these circumstances it is impossible to calculate the effective annual rate with accuracy, if at all.

For these reasons, the "time price" principle has been developed by leading reputable merchants. The customer is told the "cash price" for which the merchandise can be purchased if the payment is made in full at the time of delivery. He is also told the "time price" of the item which applies if it is purchased on a basis with instalment payments to be

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spread over terms as specified in the particular credit plan offered.

The difference between these two amounts is the "time price differential" or charge for the extension of credit to the customer. It is expressed in dollars as related to the amount of the sale or to the balance outstanding each month through the life of the contract. For the reasons previously outlined these are theonly bases of expression that are true and accurate and therefore meaningful to the customer.

The enactment of legislation that would provide for disclosure in any terms other than those previously shown to be proper and meaningful would impose a burden of computation and clerical work which, if not utterly impossible for the merchant to carry out, would at best provide inferior information to customers that could be misleading and would increase the cost of instalment sales to the customer. It would impede substantially the instalment sales transactions for retail business from the point of view of providing good service to the customer and retail instalment sales of consumer goods would be curtailed.

Further than this, such a requirement would tend to promote the deterioration of true cash sale prices and thus bring about unfair practices which would harm both the cash purchaser and the instalment purchaser. Charges would become concealed in the so-called "cash price". This undesirable development

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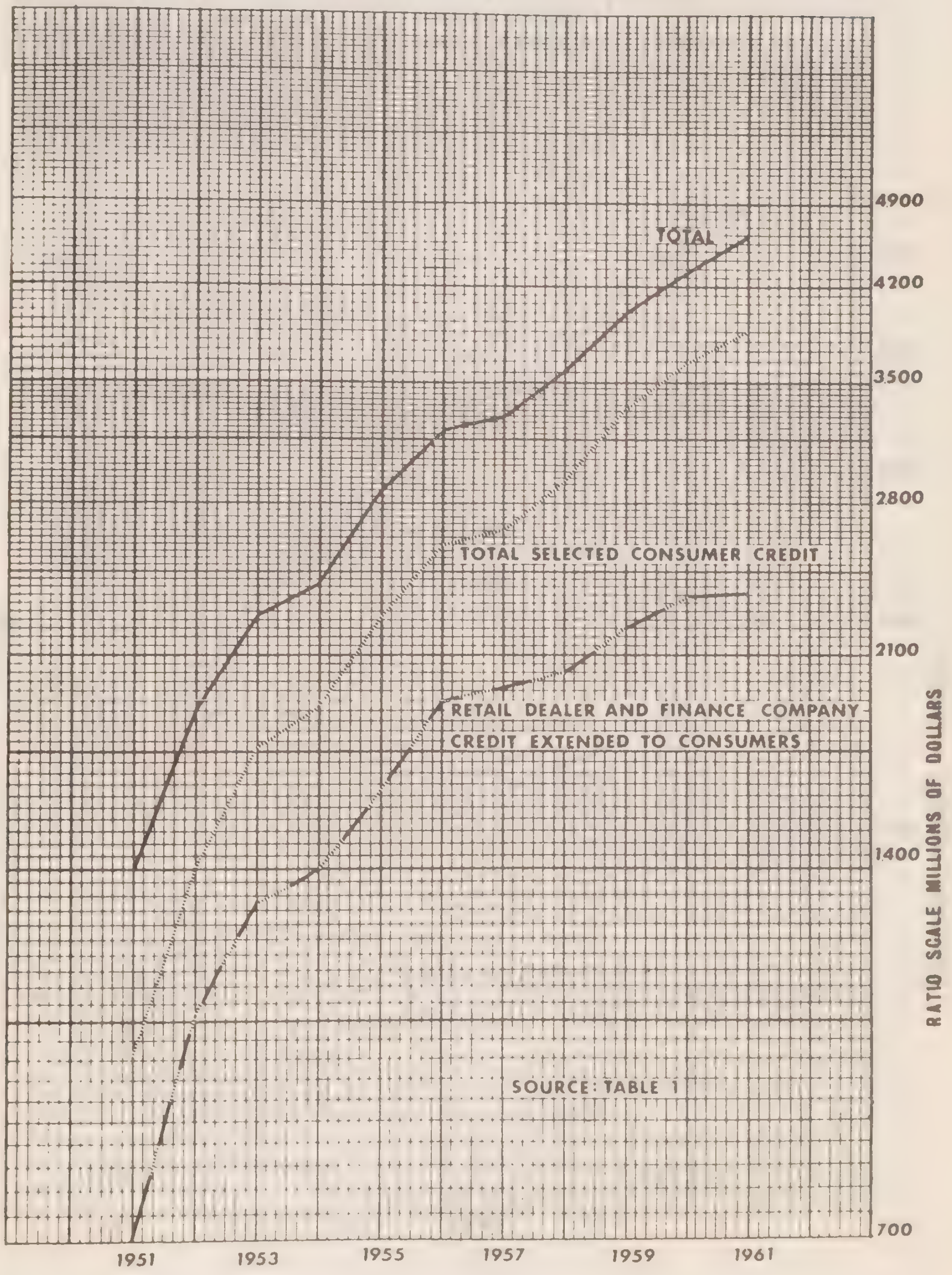
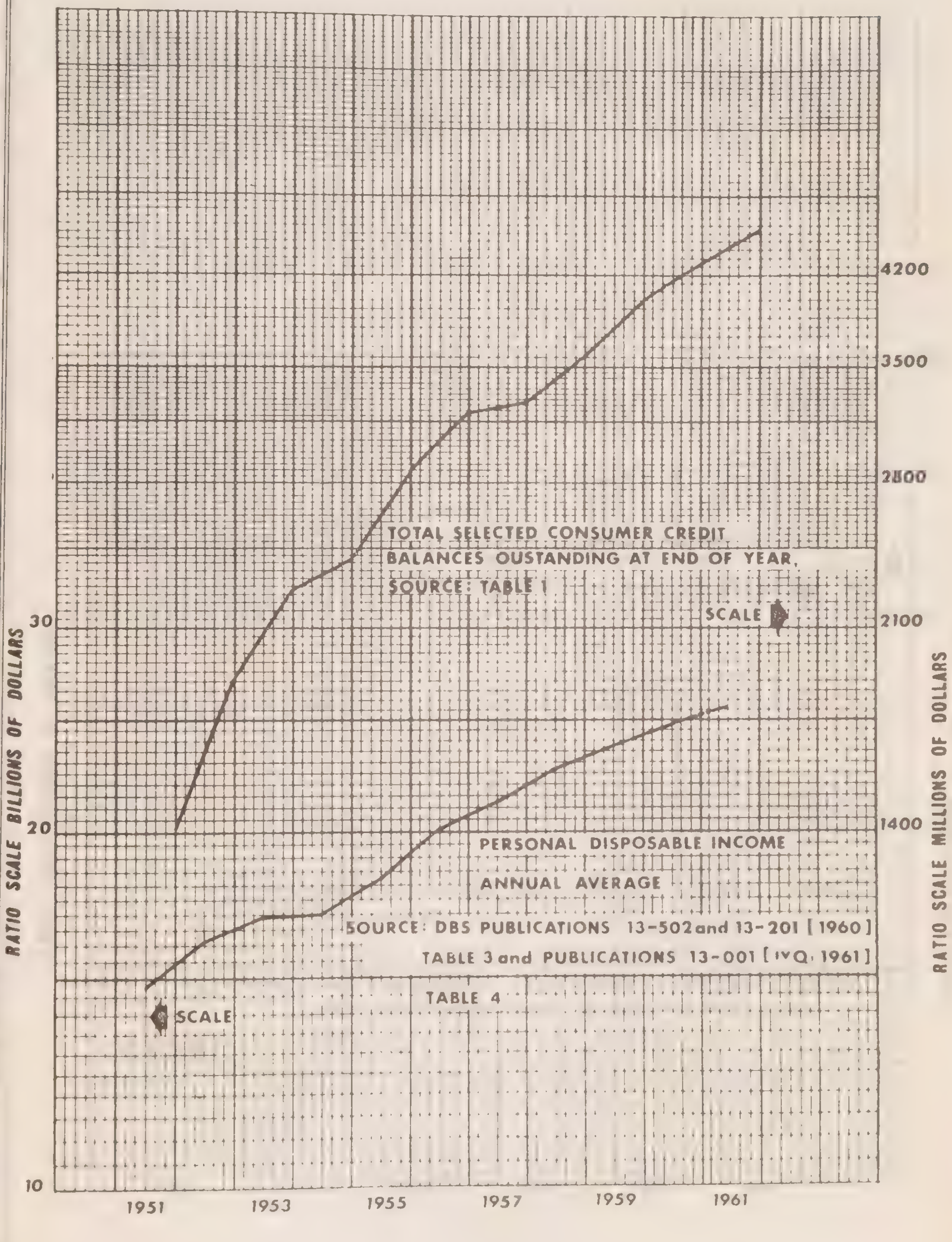
APPENDIX B1

CHART 1
SELECTED CONSUMER CREDIT
CANADA, 1951-1961
BALANCES OUTSTANDING AT END OF YEAR



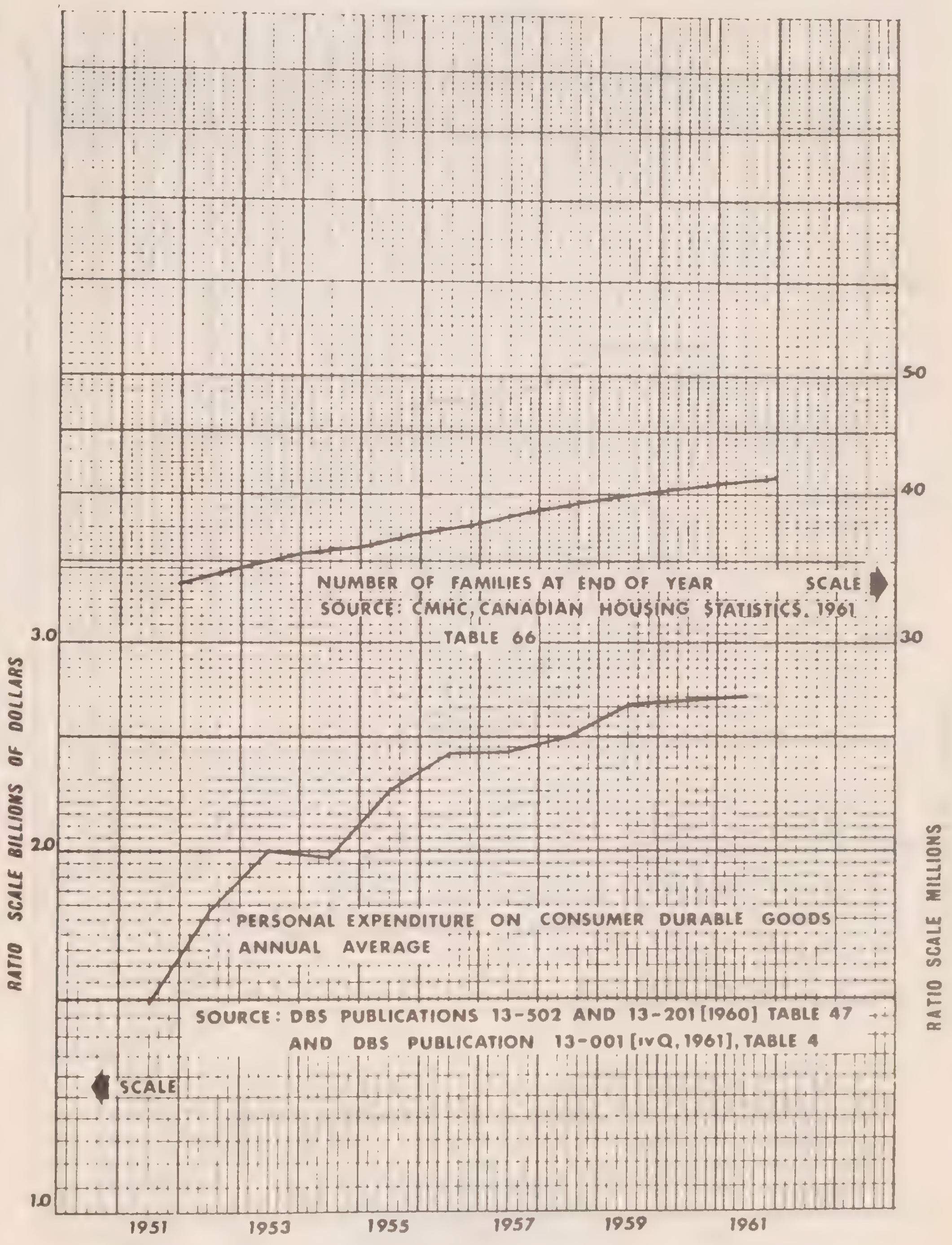
APPENDIX B2

CHART 2
CONSUMER CREDIT AND PERSONAL DISPOSABLE INCOME
CANADA, 1951-1961



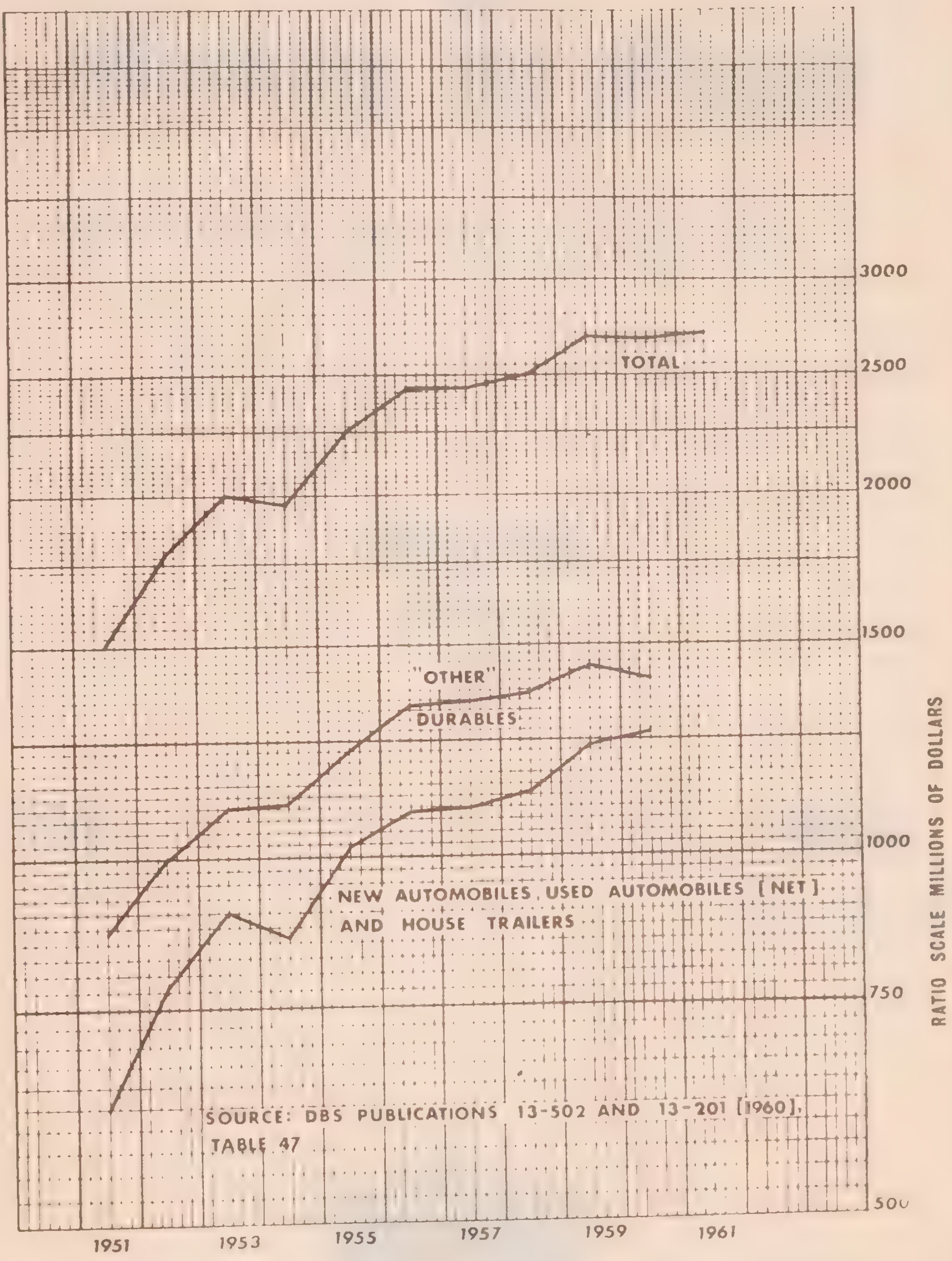
APPENDIX B3

CHART 3
NUMBER OF FAMILIES AND EXPENDITURE ON CONSUMER DURABLE GOODS
CANADA, 1951-1961



APPENDIX B4

CHART 4
PERSONAL EXPENDITURE ON CONSUMER DURABLE GOODS
CANADA, 1951-1961



Royal Commission
on
Banking and Finance

RETAIL MERCHANTS ASSOCIATION OF CANADA INC.

Hearings
held at
OTTAWA

Vol.
41A

Date.
SEPT. 28, 1962

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Toronto, Ont.

ROYAL COMMISSION ON BANKING AND FINANCE

SUBMISSION
BY

RETAIL MERCHANTS ASSOCIATION OF CANADA INC.

OTTAWA, SEPTEMBER 28, 1962

INTRODUCTION This submission is presented by the Retail Merchants Association of Canada Inc., a voluntary non-profit organization founded in 1896 and incorporated by an Act of Parliament in 1910 to represent the retail interests of Canada. The objects of the Association are:-

(a) The promotion of the industrial and commercial interests of the retail merchants of Canada;

(b) The collection and publication of information and statistics relating to or concerning such interests;

(c) The arbitration and settlement of trade disputes arising between any of its members;

(d) The procuring and furnishing to its members information as to the solvency of persons who deal with any of its members; and

(e) generally, all such other lawful and similar objects for promoting the trade interests of its members, as may from time to time be determined by the Association.

The Head Office of the Association is located in the City of Toronto and Provincial offices are maintained in Vancouver, Edmonton, Saskatoon, Winnipeg, Toronto, Montreal and Moncton.

The Retail Merchants Association of Canada Inc. is organized for the municipal to the national level. The affairs of the Association are conducted in all Canadian provinces but Newfoundland and governed by retailers who volunteer their time. Each of the Provincial Associations has its own Board of Directors, elected annually, who make Association Policy at the Provincial level. These Provincial Associations are affiliated with the Dominion Association and elect directors, by equal representation, to the Dominion Board, which sets the policy for the Retail Merchants Association of Canada Inc.

Membership is voluntary and representative of more than thirty retail classifications. At the last official count there were slightly more than 150,000 retail outlets in Canada of which approximately 95% fall into the category of Independent Retailers of the small business type. As a voluntary organization R.M.A. enjoys an active membership of about 25,000 retailers which is a good cross-section of the industry and includes small, medium and large scale operations. Being a voluntary organiz-

ation it may be observed that many others depend upon and benefit from the representations of our Association without contributing to the funds.

The chief concern of our Organization is the betterment of the retail trade; raising the standard of service to its customers and establishing and promulgating a high code of business ethics among all those who engage in the retail trade.

TERMS OF REFERENCE

"To enquire into and report upon the structure and methods of operation of the Canadian financial system, including the banking and monetary system and the institutions and processes involved in the flow of funds through the capital market."

The Commission's hearings and its final recommendations are a subject of interest to the Retail Trade and we therefore appreciate this opportunity of placing our views before you. We will endeavour to direct your attention to the relative importance of retailing in the marketing process and to the economic system of Canada. This submission will trace the development of retailing in this country to its present status and will put forward a series of practical recommendations for your consideration within the broad scope of the

"Terms of Reference".

THE ROLE OF RETAILING IN CANADA

The ability to mass produce goods is valueless unless it is supported by the ability to distribute such goods and, in the latter, retailing which spans the spacial and temporal gap between the manufacturer and the ultimate consumer is of prime importance. Because of the significance of retailing to our economic health, it would be logical to assume that everyone is familiar with the place of retailing in the economy. Yet this is not so.

Historically, retailing has been considered an unproductive second-rate institution -- a parasite of our economic system. When our economy was struggling to subsist, our entire effort was concentrated upon finding the means to produce the goods essential to life. There was no need to sell aggressively such goods, but simply to make them available. In such a climate production was considered to be solely the creation of goods. As our invenuity increased our ability to produce, we raised our standard of living above the subsistence level. We were confronted with the problem of selling the large quantity of goods produced by mass production. But the miracle of mass production overshadowed the success of retailing in selling the increased output. Our higher standard of living was

attributed to the initiative and creativity of our factories and not to the ability of our marketing system including retailing to make the goods available to the consumer. Gradually we reached our present level of affluence with its attendant problem of stimulating the rate of consumption that is prerequisite to the growth of the economy. For the first time, we are realizing that industrial activity is not a goods producing process, but rather a process designed to satisfy the wants, (i.e. things requisite, desirable, or useful), and needs, (i.e. unrecognized wants), of consumers. We realize that industrial activity must begin with the consumer and move backward to produce the products that will satisfy consumer wants and needs rather than, as in the past, producing the product and moving forward to create a customer for that product. <u>In the totality of this concept, retailing becomes increasingly important and assumes its proper place in the whole productive process.</u>

Essentially, retailing is the selling of goods and services to ultimate consumers for personal or household use. (1) But retailing is much more than the activity of selling. It can neither be divorced from nor exist outside the marketing system.

Marketing includes all business activities

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Marketing includes all business act[illegible]

that are necessary to affect the effect the transfer of title to goods and services and to provide for their physical distribution. (2) It is the activity which integrates business with society for the benefit of both. Marketing begins with the consumer. It is the task of marketing to predetermine what goods and services, in what quantities and qualities, must be produced to satisfy the wants and needs of consumers; to direct the flow of such goods and services from the producer to the ultimate consumer; to direct and influence, to some degree, the demand for such goods and services; and to provide and maintain a dynamic system that is sufficiently flexible to adapt to the ever changing environment in which it operates. The marketing task is accomplished through the efficient performance of the marketing functions; selling, buying, transportation, storage, standardization, market risk, market finance, and marketing information and research. Marketing functions are universal regardless of the institution that performs them.

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(1) Beckman, T.N. Maynard, H.H., Davidson, W.R., Principles of Marketing. 6th ed., (New York: Ronald Press Co., 1958), p. 127.

(2) Ibid p. 4

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(2) Ibid p. [illegible]

These functions cannot be eliminated; they can only be shifted forward to the consumer, backward to the manufacturer or to marketing facilitating agencies.

Retailing is a principal marketing institution and performs all of the marketing functions. Being that link in the channel of distribution closest to the ultimate consumer, retailing has the responsibility of performing the final functions necessary to deliver to consumers the standard of living they enjoy and the obligation to contribute to the ability of the economic system to achieve its objective - the satisfaction of consumer wants and needs. <u>In assuming its responsibility and discharging its obligations, retailing is productive</u>.

Economists define production as the creation of utlities which are the capacities of goods and services to satisfy human wants. Basically, utlities may be classified as form utility, place utility, time utility, and possession utility; i.e. transformation of scarce resources to increasingly satisfying states, having them available at the place the consumer wants them, at the time the consumer wants them, and at a price the consumer is willing to pay and to effect transfer of title to the consumer. Obviously, these utilities are inter-dependent and

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interact. One has little economic value without the others. Thus, production must be considered not as only the creation of form utility, but as the creation of form, place, time and possession utilities - the whole productive process. Retailing adds value to goods primarily through the creation of time, place, and possession utilities and, therefore, is an integral element in the whole productive process - not a satellite of production.

The role of retailing is to contribute to the creation of utlities by performing the marketing functions in the last stage of production and, thereby, complete the marketing task of delivering to consumers their standard of living. Performing this role, retailing is vital to manufacturers, consumers, and the economic system.

At a time when the tables of world Trade have so swiftly turned against us and we are all concerned with the problems of Industrial Expansion, not only to increase exports but to retain a larger share of our domestic markets, much is at stake for the Retail Industry. As an integral element in the whole productive process, Retailing contributes to the leadership of the economic system in the domestic environment and thereby contributes to the ability of that system to participate in Industrial Expansion. We are firmly

interact. One has little economic value without the others. Thus, production must be considered not as only the [illegible] of [illegible] utility, but as the creation of form, place, time and possession utilities [illegible] productive process. [illegible] primarily through the creation of [illegible] [illegible] and possession utilities and, [illegible] is an integral element in the whole [illegible] process - not a [illegible] of production.

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convinced that the keynotes to such expansion at home and abroad are the equalization and downward revision of Income Taxes and broadending the sources of capital for business growth.

THE STRUCTURE OF RETAILING

It is difficult to measure the magnitude and importance of retailing to the Canadian economy because of its scope. Retailing is differentiated from other business activity by the status or motive of the purchaser. Hence, a retail sale is one in which the buyer is an ultimate consumer and the motive is personal or family satisfaction. Insurmountable problems would be encountered in distinguishing retail sales from sales to business firms when the business user of a product purchases a small quantity of it from a retail store. Consequently, such sales are considered retail sales. Similarly, it would be difficult to measure the volume of sales made by manufacturers and wholesalers direct to consumers when such sales are not a regular part of their business. Thus, the importance and magnitude of the retailing task can only be approximated by quantitative measures obtained from retail establishments. Retail establishments are single places of business engaged primarily in the performance of marketing functions and out of which sales are made primarily

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to ultimate consumers. Most retail establishments are retail stores - retail establishments that are open to and frequented by the public.

The volume of retail trade varies greatly with business conditions. During the period from 1951 to 1960, sales increased by approximately 54.4 per cent as indicated in Table 1. Certainly some of the increase in sales volume is attributable to changes in price rather than to changes in the physical volume of goods distributed through retail establishments. Table 2, Column (3), indicates the physical volume of sales for the years 1953 and 1957 - 1959 expressed in 1953 dollars. It reveals the influence of price changes in those years. It is evident that the increase, expressed in constant dollars, is somewhat smaller than the increase in constant dollars. An appraisal of the trend of retailing over a period of time must consider changes in the population. When the physical volume of retail sales is expressed on a per capita basis, as shown in Table 2, Column (5), a more stable situation is apparent. The somewhat higher total physical volume of sales in 1958 compared to 1957 was offset by the increase in population. It is anticipated that the phyiscal volume of retail sales will continue

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The volume of retail trade varies [illegible] with business conditions. During the period from 1951 to 1955, sales increased by approximately 54.6 per cent as indicated in Table 1. Certainly some of the increase in sales volume is attributable to changes in price rather than to changes in the physical volume of goods distributed through retail establishments. Table 2, Column (5), indicates the physical volume of sales for the years 1951 and 1957 - 1959 expressed in 1953 dollars. It reflects the influence of price changes in those years. It is evident that the increase, expressed in constant dollars, is somewhat smaller than the increase in current dollars. An appraisal of the trend of retailing over a period of time must consider changes in the population. When the physical volume of retail sales is expressed on a per capita basis, as shown in Table 2, Column (6), a more static situation is apparent. The somewhat higher total physical volume of sales in 1953 compared to 1957 was offset by the increase in population. It is anticipated that the physical volume of retail sales will [illegible]

to increase gradually during the next decade.

In 1930, there were 124,608 retail stores whereas in 1951 there were 153,034 stores. It has been estimated that the number of stores has remained about the same during the past decade. In other words, the number of stores that have gone out of business has been replaced by the opening of new stores. As indicated in Table 3, the number of retail stores has been more stable than the volume of retail sales. In recent years, the trend has been toward a substantial increase in the scale of store operations. This trend will continue. This development has tended to increase the efficiency in the utilization of personnel and capital resources in the larger establishments. However, it has increased the intensity of the problems facing the small-scale retailer. The majority of small-scale retailers are somewhat handicapped by the lack of financial resources -- and they are confronted with increasing costs of operation. To overcome these limitations and increase the efficiency of the small-scale retailer, it will be necessary to inspire him to increase his knowledge and to guide and direct him through the dissemination of information regarding Management techniques and methods -- and the means of obtaining capital and its efficient use

through such sources as the Banks, Government Guaranteed Loans for Small Business, the Industrial Development Bank and other available channels of money supply. The alternative is to continue suffering economic losses resulting from an increase in the number of bankruptcies caused by a lack of Managerial competence and the inefficient utilization of capital.

The increase in the scale of operation coupled with increased efficiency will support the trend toward larger sales volume per establishment. As indicated in Table 4, sales per establishment more than doubled in the period from 1941 - 1951. Although the increase may become more gradual, sales per establishment will continue to climb upward.

One of the more important classifications of retail stores is by ownership. Government-owned stores, manufacturer-owned stores and farmer-owned stores account for a relatively small number of the total when compared with those owned by independent retailers, chain groups, and Co-operatives.

The single-unit independent store has long dominated the retailing structure in Canada both in terms of number of establishments and sales volume. The majority of these stores are relatively small family type

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One of the most important characteristics of retail stores is [illegible] ownership. [illegible] owned stores, manufacturer-owned stores and farmer-owned stores account for a relatively small [illegible] of the total, while [illegible] are owned by independent [illegible], partners, and [illegible].

The single-unit independent [illegible] to predominate the retailing structure in Canada both in terms of [illegible] and sales volume. [illegible]

enterprises. Organized as proprietorships, partnerships, and corporations, the sales volume of most of these stores ranges from a modest turnover to several hundred thousand dollars per annum. According to Table 5, independent stores have consistently accounted for between 79 to 83 per cent of the total volume of retail trade. It has been the aggressive small independent retailer who has pioneered many of the institutional innovations in retailing. However, the rapid development of these innovations such as the discount house and the supermarket have left the less dynamic and unimaginative retailer fighting for survival. A large number of independent retailers operate according to historical beliefs and traditional methods. Thus, although the small-scale operator tends to be more flexible than his larger competitor, he tends to be less adaptable to his changing environment. In the transition between a small-scale and large-scale operation, the independent operator is handicapped by his lack of capital resources and scale of operation in employing mechanized and automated devices that facilitate the operation of a store. This limitation unless corrected, will become more severe as greater attention is devoted to developing such devices that are applicable to retailing. In this

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dynamic age of marketing, the independent retailer will perform an important role, but to do so efficiently, he will require guidance, direction and an easier flow of credit.

Chain stores are the major competitors of the independent retailer. The Dominion Bureau of Statistics defines retail chains as, "Companies operating four or more retail outlets in the same or related kinds of business." However, a retail organization with two or more stores in the same kind of business under unified management control assumes the characteristics of a chain system and should be so recognized. The difference between the two definitions is simply a matter of degree. Usually chain store systems experience the advantages of buying power and skill, low operating costs, risk distribution, and price appeal according to the scale of their operations. Their major disadvantages, which are the advantages of the single unit store, are standardization of operating procedures, limited service, and the lack of personal contact between management and the public. As shown in Table 5, chain store sales have gradually increased their share of total retail sales. It is expected that with the opening of several chain stores in the discount field the percentage of chain store sales volume will increase during the

next two or three years. However, it is anticipated by the Retail Merchants Association of Canada Inc. that the sales volume importance of chain stores will tend to become rather stable when they amount to about 28 per cent of total retail sales volume.

Another prominent ownership group in Canada is the consumers' co-operative -- a marketing organization owned and operated for the mutual benefit of the ultimate consumers-owners who have voluntarily associated themselves for the purpose. Such organizations strive to substitute co-operative efforts of consumers for those of private enterprise. Since these organizations will be dealt with at length in another section of this brief, it will only be noted that co-operatives are able and strong competitors. The number of co-operative associations in Canada has declined somewhat since 1956, primarily because of amalgamation. However, the number of places of business has increased. (3) Sales of merchandise and supplies to members amounted to approximately $333 million in 1959. As indicated in Table 6, this is an increase of $36 million over 1958. In 1960 these sales climbed to $363 million, an increase of $30 million over 1959. Among the merchandise sold by co-operatives are food products, clothing, home furnishings, hardware, petroleum products,

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$76 million over 1956. In 1960 [illegible] sales [illegible]
climbed to $69[illegible] million, an increase of [illegible]
million over 1959. Among the largest [illegible]
of co-operatives are [illegible]
[illegible]

auto accessories, machinery and equipment, and building materials. Favoured tax treatment and untaxed patronage dividends, an inherent aspect of the co-operative movement, together with "forced loans", give these organizations an unfair competitive edge over the regularretailer.

Table 7 indicates the number of retail stores and the number of Canadians employed in retailing for the years 1931, 1941 and 1951. It should be noted that the growth in the number employed between 1941 and 1951 was substantially more than the increase in the number of stores. The increase in employment amounts to about 20 people for every store that was added to the number of establishments during the period. Although the largest stores employ considerably more than 20 people full-time, a very large number of stores employ considerably fewer people. This implies that despite the greater use of self-service, automatic vending machines and other devices there has been an increase in the number of full-time employees per store. In part this is explained by the fact that although the greater use of self-service reduces the number of sales people required, the trend toward larger scale operations and

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(3) Canada Year Book, 1961, p. 914

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[illegible]nd building materials.

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increased specialization results in a larger number of managerial employees and the establishment of staff departments. It has been estimated that during the past ten years, more than 600,000 people or one out of every ten people working in the Dominion are employed in retailing. The employment of many other people whose jobs are intimately linked to retailing is dependent upon the economic health of retailing.

The percentage of sales of major trades to total volume of retail sales is shown in Table 8. As would be expected general stores accounted for a declining percentage of retail trade volume. The increasing use of automobiles and the improvement in highways which make urban retail centres more accessible to rural residents will continue to reduce the importance of the general store. Grocery and combination stores predominated by chain systems have accounted for an increasing percentage of total retail sales. To some extent, further increases in this trade category will depend upon the ability of the stores to effectively merchandise an increasing variety of goods. As would be expected, motor vehicle dealers have accounted for an increasing percentage of total retail sales. The percentage of sales accounted for by department stores has been relatively stable

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The percentage of sales of major trade groups to total volume of retail sales is shown in Table 5. As would be expected general stores accounted for a declining percentage of retail trade volume. The increasing use of automobiles and the improvement in roads which make urban retail centres more accessible to rural residents will continue to reduce the importance of the general store. Chain and combination stores predominated by chain systems have accounted for an increasing percentage of total retail sales. To some extent, further increases in this trade category will depend upon the ability of the stores to effectively merchandise an increasing variety of goods. As would be expected, motor vehicle dealers have accounted for an increasing percentage of total retail sales. The percentage of sales accounted for by

since 1951. As indicated in Table 9, they have accounted for between 8.5 and 8.8 percent during the period from 1954 to 1960.

CONSUMER CREDIT

The importance of retailing to the Canadian economy is also underlined by its role in the area of consumer credit. The existence of people with wants does not create markets for goods and services. Aside from the willingness, (i.e. the recognition by the consumer that a product or service will satisfy a want), of the consumer to buy, the sale of goods is dependent upon the ability of the consumer to buy. Thus, purchasing power is required to translate wants into effective demand. Purchasing power is primarily dependent upon income. However, in the short run, income and, therefore, purchasing power, can be supplemented by the extension of consumer credit. Consumer credit does not create purchasing power but simply influences it by making it possible for consumers to purchase products to satisfy their wants by pledging future income. Obviously, in the long run, income is required to redeem credit that has been extended. Table 10 indicates that between 1951 and 1959, retail trade credit, based on the balance outstanding was the leading source of consumer credit during six years. During the other three years, it was second

only to chartered banks. In view of the seasonal variations in retailing and the burden the extension of credit places on the working capital resources of retailers, this level of consumer credit is particularly significant. During the coming years, the extension of credit by retailers will become increasingly great. Table 11 shows the breakdown of retail credit, accounts outstanding, by charge and instalment accounts for the years 1952 - 1959. As in 1958 and 1959, instalment credit will probably continue to be more important. This will add additional strain on the retailers' existing capital; additional strain on the retailers' ability to locate sources of capital and necessitate efficient use of capital by retailers.

SOURCES OF RETAILERS' CAPITAL

Generally speaking the corporate chain system have access to capital in the stock and bond markets and with this capital they have experienced a satisfactory rate of growth. The small scale independent retailer is handicapped, by his size, in locating sources of capital. For the most part, he must depend upon his own resources, his established lines of credit with the bank and suppliers, and private sources including relatives and friends. Other potential sources include loans granted under the Government Guaranteed Loans for Small Business

program and the Industrial Development Bank. Primarily, the capital requirements of the small scale retailer stem from the needs for funds for store modernization, inventory and the extension of credit. Typically his needs are relatively modest.

To a degree, trade credit offsets the needs of the retailer with respect to financing his day-to-day inventory requirements. But trade credit is not completely adequate. Many small scale competent retailers do not have the capital to take advantage of opportunities, where it is advisable or deemed necessary for growth, to increase the level of inventories, broaden the variety or assortment of their merchandise offerings, or to take advantage of special purchases which promise rapid turnover and a reasonable profit. Short term bank loans contribute to the ability of the retailer to meet his seasonal inventory requirements but they are seldom of sufficient amount or duration to promote a more rapid rate of his business expansion.

The trend to larger scale operations and the continuing growth in the extension of instalment credit will further strain the capital of the average independent retailer. Store modernization, which should be a continuing process, and the purchase of modern fixtures and equipment are, in many cases

prohibited by the lack of funds.

The Government recognizes the urgency of these problems, or so it would appear, and has enacted a bill to provide Government Guaranteed Loans for Small Business (effective January, 1961) and amended the Industrial Development Bank Act in the following month of July, broadening its lending policies to include, among others, retailers and wholesalers. While these actions are commendable, it is the view of the Retail Merchants Association of Canada Inc. that further steps remain to be taken by way of amending these Government lending programs and in addition, creating new sources of capital for Independent Retailers and the other segments of small business.

GOVERNMENT GUARANTEED LOANS FOR SMALL BUSINESS

"Business improvement loans may be made to enterprises engaged in manufacturing, retail trade, wholesale trade as well as to service businesses, provided annual gross revenues are not in excess of $250,000.00. The proceeds of such loans can be used for a wide variety of purposes including the purchase and improvement of equipment as well as the extension and renovation of business premises." (4)

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(4) Annual Report 1961 Small Businesses Loans Act, Department of Finance

1961 Loans to the Retail Trade

	Total Number	Total Amount
Grocery Stores	241	$1,759,213
Clothing Stores	98	782,369
Hardware Stores	63	434,324
Equipment Stores	53	282,153
Department Stores	105	669,193
Furniture Stores	45	431,986
Electrical Stores	47	265,593
Drug Stores	86	664,153
Miscellaneous Retail Stores	227	1,458,351
	965	$6,747,335

Loans to Retailers accounted for about one quarter of total loan disbursements. (5)

When it is considered that these loans were granted during the first year of this program and that a considerable period of time was required to launch the program through the Chartered Banks of Canada and communicate the availability of these funds to Small Business, the experience of the first year would appear to be satisfactory. However, it is our observation that, while the lending principles are sound, the volume limitation is an unnecessary restriction and discriminates against some types of Small Business. Removal of this section of the Act would qualify more

(5) IBID p. 10.

retailers for loans and accelerate the movement of these funds into capital expenditures. We therefore respectfully propose:

1. The elimination of that Section of the Act (9 Elizabeth II, Chap. 5, 2.(m)) which stipulates that, to qualify, annual revenues of a business must not be in excess of $250,000.00.

Obviously this requirement is nothing more than an attempt to define Small Business. However, this volume limitation of the Act does not consider differences in the scale of operations of different classes of retailers. For example, a supermarket with a sales volume of $75,000.00 - $375,000.00 is considered a superette or a small super-market whereas a single unit independent hardware store with a sales volume of $375,000.00 would be a large-scale operation. Similarly a departmentalized specialty store with a sales volume of $500,000.00 would be a large-scale operation compared with a small dress shop with two or three employees but would be a small-scale operation compared to a department store with many times that number of employees and over $1,000,000.00 in annual volume.

For these reasons this section of the Act is somewhat discriminatory against some

classes of small business and might well be deleted or amended. It is our view that for the purposes of the Act, Small Business is better defined by its money requirements and the loan ceiling of $25,000.00, in itself, limits borrowing to small business enterprises.

2. Broaden the lending base of the Small Businesses Loans Act to include, in clearly defined terms, the granting of loans to qualified applicants for the purposes of establishing new businesses.

In consideration of the security required by the banks, in addition to the government guarantee of 10% (9 Elizabeth II, Chap. 5, 8(1) (2) Bank Security) this would appear to be a reasonable and logical amendment to give impetus to the establishment of new businesses.

On the question of new premises the amendment to the Regulations on May 17th, 1962, provides that loans may be granted for the purpose of financing the construction or purchase of alternative premises. For the purposes of the Act, this is a practical change. Our recommendation is simply a request to carry the lending program one step further. It would serve to encourage existing proprietorships in the establishment of new, additional outlets by strategic location, to keep pace with changing shopping habits and

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the shift in population. In the Retail Industry, the need develops from the growth patterns to which we have previously referred. In addition such an amendment would stimulate Small Business in Canada by encouraging new entrants into the field.

3. Government sponsored loans for Small Business should be more vigorously promoted by the Chartered Banks and the Federal Departments of Finance and Labor.

Such a program might include, primarily, an improved line of communication between the Head Offices of the Banks and their Branch Managers on the subject of these loans and the service to the community they will perform. Printed folders for counter distribution are notable by their absence. In the past two years the Winter Works Program has made some effort to associate Improvement Loans with Winter employment. It is our view this approach should be continued in an even more aggressive way and brought to the attention of Small Business and encouraged by all Branch Bank Managers across Canada. In the final analysis it is the Branch Bank Manager upon whom the success or failure of this lending program largely depends.

During the year 1961, 2,977 loans were granted under the Small Businesses Loans Act

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During the year 1961, 4,5[illegible]7 loans were granted under the Small Business Loans Act,

(Manufacturing, Wholesale Trade, Retail Trade and Service Businesses) for a total amount of $25,582,269. (Annual Report 1961 Small Businesses Loans Act). When it is considered that as at July 31st, 1962 there were 5,288 branches, including sub-branches and sub-agencies of the Canadian Chartered Banks, it is immediately evident that a large number of branches have not processed a single loan under the program. This would serve to substantiate in part, at least, the large number of reports we receive from the trade that some local bank managers do not appear to be sympathetic to the objectives of the Small Businesses Loans Act and are lacking in their appreciation and understanding of its terms and regulations.

For the period ending on December 31, 1963, the Government guarantee will apply to a maximum of $300 million which may be lent by all the banks. It is apparent therefore that the experience of the first year falls short of anticipated borrowings and a vast pool of money remains available.

From an economic point of view a stepped-up lending program for Small Business Improvements will have the effect of stimulating employment and increasing the demand for goods and materials, all of which will be reflected in a higher rate of personal income

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and purchasing power.

For these considerations, if no other, we submit our recommendations are worthy.

INDUSTRIAL DEVELOPMENT BANK

In 1944 the Parliament of Canada established the Industrial Development Bank to help finance small and medium-size Canadian businesses in the fields of manufacturing and food processing. Since that time IDB has an excellent record of performance and can point with pride to flourishing Canadian Businesses which at one time or another were in need of financial assistance. IDB loans have helped such firms establish, expand and modernize and, in so doing, have made an important contribution to the growth of Canadian Industry.

It will be noted, however, that until recently the lending policies of the Industrial Development Bank were aimed primarily at productive industries in the sense that manufacturing and food processing were the principle components of production and Small Business in this category needed help. But times have changed. This submission has illustrated the extent to which retailing has become an integral part of the marketing process and this, in part, may account for the amendments to the Industrial Development Bank Act, last year, extending borrowing facilities to the Retail Trade, among others. As a result we feel that IDB loans to retailers,

while somewhat limited by IDB Policy, will, nevertheless, be of substantial assistance to the medium and larger types of merchants. However, it remains that an even greater area of service can be performed by revamping policies to accommodate retailers whose requirements are substantially less than their larger competitors and contained within the bracket of $5,000.00 - $25,000.00.

We have directed the attention of the Commission to the strain which is imposed on the average competent independent retailer as the result of the trend to larger scale volume operations and the growth in the extension of consumer credit. We assert that an easier flow of credit, properly secured, to the Independent Retail Trade is a matter which deserves the attention of your Commission.

Therefore, it is our recommendation that the Industrial Development Bank give careful consideration to this aspect of retailing with a view to changing its present policy in favour of granting loans, with appropriate security, to provide funds for financing inventories and receivables.

CHARTERED BANKS, TRUST COMPANIES AND OTHER FINANCIAL INSTITUTIONS

Predicated on the case we have made in respect to the financial requirements of a large percentage of Retailers in this country, essential to growth and efficiency -

[illegible]

nevertheless, be of substantial assistance to the medium and larger types of business. However, it remains that an even greater area of service can be performed [illegible] policies to accommodate retailers, whose requirements are [illegible] than those larger competitors and [illegible] within the [illegible] of $5,000 [illegible] $10,000.

We have [illegible] the attention of this Commission to the [illegible] which is imposed on the average consumer [illegible] as the result of the trend to larger scale volume operations and the growth in the extension of consumer credit. We suggest that an easier flow of credit, properly secured, to the independent Retail Trade is a matter which deserves the attention of your Commission.

Therefore, it is our recommendation that the individual [illegible] consideration to this aspect of retailing with a view to [illegible] policy in favour of granting [illegible] security, to provide funds for [illegible] inventories and receivables.

MANUFACTURERS, TRADE CREDITORS AND OTHER LENDING INSTITUTIONS

Predicated on the [illegible] we have [illegible] in relation to the financial requirements of [illegible] a large percentage of retailers in [illegible] country, [illegible]

and their limited sources of money supply, we respectfully suggest that the Chartered Banks and other financial institutions should be permitted and encouraged to broaden the sources of capital to Independent Business Enterprises. It is our view that the chartered banks should be authorized to lend on mortgages, hypothec or assignment upon real or personal immovable or movable property. Some precedent for this procedure is now established by the Small Businesses Loans Act, "Special Powers of Bank" 8 (1) (2).

Such an arrangement would facilitate the granting of term loans by the Chartered Banks to meet business contingencies and could be encouraged by a rate of interest commensurate with the risk, thereby making such loans more attractive to the Banks.

On this subject we are heartened, somewhat, by the formation of ROYNAT LTD. which proposes to provide assistance for Canadian Companies engaged in manufacturing, processing, wholesale and retail trades, transportation, construction and service industries generally. Roynat will not be confined to existing businesses - it will also encourage new ventures. Loans starting at $25,000.00 will be considered. Roynat Ltd. invites enquiries through over 1,600 Branch Bank and Trust Company offices across Canada of the

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Royal Bank of Canada, Banque Canadienne Nationale, The Canada Trust Company and the Montreal Trust Company.

We cite the formation of this Company as an example of what can be done, in addition to Government sponsored lending, to broaden the sources of capital to business and industry. We reiterate the necessity of similar plans for competent businesses whose capital requirements are less than $25,000.00.

GENERAL

Retailing is a great marketing institution that has made significant contributions to our way of life. Its tradition is rich and the future is bright. However, in a dynamic economy, retailing cannot stand still. Its patterns will change in response to our evolving mode of living. In this era of rapid change, increasing technology and new knowledge, the institutional components of the economic system must comprehend the mentality of the marketing task and orient themselves to satisfying the want and needs of customers. Retailing, a principle marketing institution, occupies an important part in the task of marketing. However, its role, structure and function must be recognized and its development encouraged by Government, the complex of industry and the society it serves.

One of the great needs in retailing is

the encouragement and direction for Retailers in the use of marketing information and the availability of such information. To know what to do today, a retailer must know what the firm should be doing next year and the year after as well as five and ten years hence. Retailers must analyze their firms to determine their weaknesses, which must be eliminated, and their strengths upon which to build. Such a program must be accompanied by an analysis of the environment to determine the external factors which influence the development of the firm. The retailer must be informed about such factors as population characteristics; consumer behaviour; habits, customs, and attitudes; trade behaviour; government attitude; competition; style and fashion, and the relation of such factors to the nature of demand for the type of goods offered by the store. Only by collecting and disseminating such information and encouraging and directing the retailer to effectively plan, organize and control the activities of his firm can the task of retailing be performed.

Retailing has within its power the ability to direct the way to a higher standard of living and to contribute to the dynamic growth of our economy. To measure up to this responsibility, many retailers

require guidance and direction. Banks, the Government and Industry as well as Trade Associations can provide this type of assistance, particularly to the small-scale retailer who lacks the financial capacity to employ specialized management.

Banks are in a favourable position to contribute much towards helping the small-scale retailer in financial management by way of personal counselling and newsletters. However this requires a genuine effort on the part of bank managers to not only make such consulting services available but to actively promote the availability of these services among their retail accounts. In this manner they can encourage retailers to adequately plan their financial requirements for operating and instruct them in the use of budgets and other forms of statements essential to the development of the retailer and the conduct of a successful business.

Certainly the Government must recognize the importance of retailing to Canada's economic system and, apart from tax considerations, sponsored lending programs and other legislative activities, the Government should sponsor more research into retailing and provide for the dissemination of marketing and retailing information. In this respect the Small Business Branch of the Department

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of Trade & Commerce might well initiate the necessary leadership.

There is a dearth of data regarding retailing in Canada. Much of the factual literature on the subject is based on inferences drawn from studies in the United States. Certainly such data are interesting and valuable. But it is inexcusable that Canada's experience must be reported in the light of the United States experience in retailing because of the lack of such data in Canada. Only by investigating in Canada, can Canada experience the records of an efficient retailing system and contribute to retailing knowledge.

SUMMARY

May we summarize our views as expressed in this brief as follows:

1) Retailing is an integral element of the productive process. It contributes to the leadership of the economic system in the domestic environment and thereby contributes to the ability of that system to participate in Industrial Expansion. Keynotes of such expansion are the equalization and downward revision of Income Taxes and broadening the sources of capital for Business Growth.

2) Independent stores have consistently accounted for between 79 and 83 percent

of the total of retail trade.

3) The sales volume importance of chain stores will tend to become rather stable when it amounts to about 28 percent of the total retail sales volume.

4) In this dynamic age of marketing, the independent retailer will perform an important role, but to do so efficiently, he will require guidance, direction and an easier flow of credit.

5) The Small Businesses Loans Act should be amended:

   a) To remove the Gross Revenue Limitation of $250,000.00 for the fiscal period of the business enterprise in which the application for a loan is made.

   b) To broaden the lending base of the Act to include loans for the establishing of new businesses.

6) Government sponsored loans for Small Business should be more vigorously promoted by the Chartered Banks and the Federal Departments of Finance and Labor.

7) The Industrial Development Bank should review its policies with a view to granting loans, properly secured, to provide funds for financing inventories and receivables.

of the total of retail trade.

3) The sales volume importance of chain stores will tend to become rather stable when it amounts to about 23 percent of the total retail sale volume.

4) In this dynamic age of marketing, the independent retailer will perform an important role, but to do so efficiently, he will require guidance, direction and an easier flow of credit.

5) The Small Businesses Loans Act should be amended:

a) To remove the Gross Revenue limitation of $250,000.00 for the fiscal period of the business enterprise in which the application for a loan is made.

b) To broaden the lending base of the Act to include loans for the establishing of new businesses.

6) Government sponsored loans for Small Business should be more vigorously promoted by the Chartered Banks and the Federal Departments of Finance and Trade.

7) The Industrial Development Bank should review its policies with a view to granting loans, properly secured, to [illegible] and receivables.

8) Chartered Banks and other financial institutions should be encouraged to grant term loans to meet business contingencies, secured by mortgages and other forms of collateral, at a rate of interest to make such loans attractive to the lenders.

9) The Government should sponsor more research into retailing and provide for the dissemination of marketing and retailing information. The Small Business Branch of the Department of Trade and Commerce might well initiate the necessary leadership.

All of which is respectfully submitted.

RETAIL MERCHANTS ASSOCIATION OF CANADA INC.

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[illegible]

TABLE 1

VOLUME OF RETAIL SALES[4] BY
PROVINCES, 1930, 1941, 1951 - 1960

(Millions of Dollars)

Year	Atlantic Provinces[1]	Quebec	Ontario	Manitoba	Saskatchewan	Alberta	British Columbia[2]	Canada[3]
1930	197	646	1,091	188	188	175	251	2,736
1941	279	820	1,388	193	189	228	318	3,415
1951	899	2,443	4,130	610	659	854	1,100	10,693
1952	982	2,635	4,383	651	764	939	1,177	11,532
1953	1,018	2,756	4,616	677	845	987	1,228	12,128
1954	1,025	2,798	4,634	637	758	964	1,249	12,066
1955	1,127	3,006	5,115	669	748	1,035	1,412	13,112
1956	1,211	3,322	5,499	700	812	1,159	1,594	14,298
1957	1,234	3,521	5,663	726	855	1,211	1,616	14,826
1958	1,290	3,647	5,934	754	914	1,275	1,631	15,444
1959	1,362	3,878	6,218	813	951	1,355	1,707	16,284
1960	1,430	3,944	6,313	843	938	1,366	1,668	16,502

Sources: Canada Year Book 1961, Retail Trade by Provinces, 1930 and 1941 - 1959, p. 887
Dominion Bureau of Statistics, Retail Trade, 1960, p. 7

1. Newfoundland included since 1949
2. Yukon and Northwest Territories included
3. Total not exact in addition of components because of rounding of figures
4. Estimates not adjusted for Price Changes.

TABLE 2

DOLLAR AND PHYSICAL VOLUME OF SALES OF RETAIL ESTABLISHMENTS AND PHYSICAL VOLUME PER CAPITA - CANADA, 1953 and 1957 - 1959

Year	Retail Sales in Current Dollars (Millions) (1)	Index of Retail Prices 1953 = 100 (2)	Physical Volume of Retail Sales in 1953 Dollars (Millions) (3)	Population (Millions) (4)	Physical Volume of Retail Sales Per Capita in 1953 Dollars (5)
1953	12,128	100	12,128	14.8	819.45
1957	14,826	106	13,987	16.6	842.59
1958	15,444	108	14,300	17.0	841.17
1959	16,284	110	14,804	17.4	850.80

Sources:

(1) Canada Year Book, 1961, Retail Trade, 1930 and 1940 - 1959, p. 887
(2) Canada Year Book, 1961, Index Numbers of Retail Prices in Canada and Other Countries, 1957-59, p.950
(3) Data in Column (1), divided by data in Column (2) x 100
(4) Canada Year Book, 1961, Estimates of Population, by Province, as at June 1, Intercensal Years 1941-60, P. 165. Figures have been rounded.
(5) Data in Column (3) divided by data in Column (4)

TABLE 3

Number of Retail Stores By Kinds of Business, 1930, 1941, 1951

Year	Total all Trades	Grocery and Combination (1)	Meat (2)	General (3)	Department (4)	Variety (5)	Men's Clothing (6)	Family Clothing (7)	Womens Clothing (8)	Shoes (9)	Hardware (10)	Furniture (11)	Appliance and Radio (12)	Drug (13)	Jewellery (14)	All Other (15)
1930	124,608	23,328	5,017	11,915	148	513	3,969	1,149	1,752	1,641	3,001	1,100	1,342	3,559	1,532	64,642
1941	136,990	27,985	4,538	11,917	504	1,085	3,485	1,934	3,278	1,674	3,020	1,337	1,648	3,956	1,692	68,937
1951	153,034	34,548	3,171	10,546	649	1,392	3,997	2,698	4,089	2,261	3,896	1,765	2,818	4,342	2,616	74,246

Source: Dominion Bureau of Statistics, Retail Trade, 1930-1951, Reference Paper No. 56, p. 4-5

(1) Grocery and combination stores (grocery and meats) are as indicated with a maximum of 85% fresh meats allowed.
(2) Meat markets must not sell more than 15 percent grocery items and remain in this classification.
(3) General stores, usually located in rural areas, selling over 33 percent groceries; do not include general merchandise stores selling a smaller amount or no groceries more commonly found in towns and cities.
(4) Department stores include mail order sales. This class does not include large departmentalized clothing stores which sell no durable goods such as furniture or appliances.
(5) Variety stores sell a low-price range of goods, prominently displayed - cash and carry characteristics - popularly known as 5¢ - $1.00 stores; most prevalent in the "chain" field.
(6) Men's clothing stores include men's and boys' clothing and furnishings, hat stores and custom tailors.
(7) Family clothing stores are those selling mainly men's, women's, children's and infants' clothing and may handle other dry goods not in excess of 50 percent.
(8) Women's clothing stores exclude furriers, millinery shops, and infants specialty stores. These are included in the "all other" classification.
(9) Shoe stores include specialty men's or women's shoes stores together with family shoe stores.
(10) Hardware stores cover regular hardware stores and those selling farm implements.
(11) Furniture stores include those selling at least 67 percent furniture and also where undertaking is part of the business but not inexcess of 50 percent.
(12) Appliance and radio stores include specialty stores dealing in these commodities (over 67 percent) and also the combination group of furniture and appliance except those defined above as furniture stores.
(13) Drug stores and those with and without soda fountain.
(14) Jewellery stores sell mainly jewellery, silverware, clocks and watches with additional lines such as luggage, gifts and novelties. Repairs must not exceed 50 percent of total trade.
(15) "All Other" includes all trades not specified above and contains certain major trades such as government liquor stores, farm implement dealers, farm supplies including feed and seeds, etc., used car dealers and confectionery stores. The above table includes motor vehicle dealers, garages and filling stations, lumber and building material dealers, restaurants, fuel dealers and tobacco stores.

TABLE 4

NUMBER OF RETAIL STORES AND VOLUME OF SALES PER ESTABLISHMENT, 1930, 1941, 1951

Year	Number of Establishments (1)	Physical Volume of Sales In Current Dollars	
		Total Amount (Millions)* (2)	Per Establishment
1930	124,608	2,736	$21,956
1941	136,990	3,415	$24,928
1951	153,034	10,693	$69,873

Source:
(1) Dominion Bureau of Statistics, Retail Trade, 1930-1951 Reference Paper No. 56, p 4-5
(2) Dominion Bureau of Statistics, Retail Trade, 1930-1951 Reference Paper No. 56, p. 1
(3) Data in Column (2) divided by Column (1)

* Figures have been rounded.

TABLE 5

VOLUME OF SALES AND THE PERCENT OF MARKET BY CHAIN AND INDEPENDENT STORES

1930, 1941, 1951 - 1960

	CHAIN STORE		INDEPENDENTS	
Year	Net Sales (1)	Percent of Total Retail Sales	Net Sales	Percent of Total Retail Sales (2)
	$000,000		$000,000	
1930	487	17.8%	2,249	82.2%
1941	639	18.7%	2,776	81.4%
1951	1,775	16.6%	8,918	83.4%
1952	1,925	16.7%	9,606	83.3%
1953	2,048	16.9%	10.079	83.1%
1954	2,147	17.8%	9.918	82.2%
1955	2,354	18.0%	10,752	82.1%
1956	2,647	18.5%	11,652	81.5%
1957	2,842	19.2%	11,979	80.8%
1958	3,073	19.9%	12,371	80.1%
1959	3,273	20.1%	13,011	79.9%
1960	3,468	21.0%	13,034	79.0%

Source: Canada Year Book, 1961, Retail Chain Store Statistics, 1930, 1941-1959, p. 888
Dominion Bureau of Statistics, Retail Trade, 1960, p. 6

(1) Figures rounded by author
(2) Computed by author from Table, p. 6, Retail Trade, 1960, Figures Rounded

TABLE 6

CO-OPERATIVE MARKETING AND PURCHASING ASSOCIATIONS, 1951 - 1960

	Co-Operative Marketing and Purchasing Associations		
Year	Number of Associations	Number of Places of Business	Sales of (1) Supplies in Millions $
1951	2,348	5,830	210
1952	2,194	5,470	235
1953	2,221	4,987	246
1954	2,086	4,510	235
1955	1,949	5,016	228
1956	2,041	5,171	259
1957	2,022	5,023	284
1958	2,002	5,135	297
1959	1,982	5,267	333
1960	1,938		363 (2)

Source: Canada Year Book, 1961, Summary Statistics of Co-operative Marketing and Purchasing Associations, Crop Year ended July 31, 1950-1959, p. 915

(1) Figures rounded by author
(2) R. Craig McIvor, Recent Growth in Canadian Co-operatives, June, 1962

TABLE 7

NUMBER OF RETAIL STORES AND EMPLOYMENT IN RETAILING

	1931 (1)	1941	1951
Number of Retail Stores	124,608	136,990	153,034
Employment Full-time	238,683	297,047	Average Minimum 454,794 Average Maximum 603,891

Source: Canada Year Book, 1961, Statistical Summary of The Progress of Canada, Page 1254

(1) Census Figures for 1930

TABLE 8

PERCENTAGE OF SALES OF MAJOR TRADE TO TOTAL VOLUME FOR SPECIFIED YEARS

MAJOR TRADES (1)	1930	1941	1951	1954	1950	1960
Total All Trades	100	100	100	100	100	100
Grocery and Combination	14.8	16.6	17.8	18.9	20.2	21.1
General Stores	7.6	6.3	4.9	4.3	3.9	3.9
Department Stores	13.0	11.1	8.5	8.8	8.7	8.8
Furniture, Appliance, Radio	3.4	3.2	3.4	4.0	3.6	3.3
Clothing, Shoe Stores	7.3	7.9	6.5	6.1	5.6	5.7
Hardware, Building Materials	5.0	4.5	5.5	5.4	5.0	4.6
Motor Vehicle Dealers	9.2	10.5	17.6	16.8	16.0	15.5
Total Major Trades	60.3	60.1	64.2	64.3	63.0	62.9
All Other Trades	39.7	39.9	35.8	35.7	37.0	37.1

Source: Dominion Bureau of Statistics, Retail Trade, 1960, p. 7

(1) For a description of kind of Business, see Table 3.

TABLE 9

DEPARTMENT STORES

NET SALES AND PERCENT OF TOTAL RETAIL SALES

Year	DEPARTMENT STORES	
	Net Sales $000,000	Percent of Total Retail Sales
1954	1,062 (1)	8.3%
1955	1,150	8.3%
1956	1,242	8.7%
1957	1,282	8.7%
1958	1,345	8.7%
1959	1,420	8.7%
1960	1,453 (1)	8.8%

Source: Canada Year Book, 1961, Retail Trade by Kinds of Business 1955-1959, p. 887

Dominion Bureau of Statistics, Retail Trade 1960

1. Computed by taking percentage of Total Retail Trade.

TABLE 10

CONSUMER CREDIT - BALANCES OUTSTANDING ON RETAIL TRADE CREDIT AND LOANS EXTENDED FOR NON-BUSINESS BY CERTAIN FINANCIAL INSTITUTIONS, 1951 - 1959

(Millions of Dollars)

Year	Retail Trade Credit	Sales Finance Companies	Small Loan Companies	Chartered Banks	Credit Unions	Life Insurance Co. Policy Loans
1951	406	186	114	435	76	199
1952	552	373	148	506	94	213
1953	624	516	176	585	129	225
1954	685	492	215	612	151	240
1955	751	599	279	788	174	250
1956	798	756	356	759	219	270
1957	826	780	368	691	248	295
1958	860	768	400	842	313	304
1959	915	806	484	1,001	394	323

Source: Canada Year Book, 1961, p. 892

TABLE 11

RETAIL CREDIT, 1952 - 1959

Year	Accounts Receivable (at end of period)		
	Instalment $000,000	Charge $000,000	Total $000,000
1952	246.2	451.3	697.5
1953	287.8	483.6	771.4
1954	326.6	492.7	819.3
1955	381.8	542.8	924.6
1956	414.9	566.6	981.5
1957	485.1	529.1	1,014.2
1958 [1]	489.6	477.6	937.2
1959 [1]	523.8	468.7	992.5

Source: Canada Year Book, 1961, p. 893

(1) Excludes lumber and farm implement dealers. (Thus results more closely approximate "Consumer" credit as shown in Table 10).

S U B M I S S I O N

ROYAL COMMISSION ON BANKING AND FINANCE

PRESENTED BY: THE EQUITABLE INCOME TAX FOUNDATION

** Value of Fair Competition

** Reasons for Commission concerning itself with particular Taxation inequities.

** Taxation of Co-operatives

** Credit Unions

** Conclusions and Recommendations

Ottawa September 28, 1962

ROYAL COMMISSION ON BANKING AND FINANCE

SUBMISSION OF

THE EQUITABLE INCOME TAX FOUNDATION

Certain aspects of the effects of taxation on the Canadian financial system particularly as it affects investments generally and the flow of funds through the capital market.

Introduction

The following section of the brief is presented by The Equitable Income Tax Foundation. The Foundation is a new body established to achieve the following purposes:-

(a) To encourage study, research and investigation on the subject of taxation and its affect on the Economy of Canada and, in particular, to study the adverse affects of inequitable Taxation on the economic growth of Canada;

(b) To publish and disseminate information on Taxation and related subjects and propogate the principals of equitable Taxation;

(c) To study the various taxing statutes and regulations of the Dominion and the Provinces of Canada and to make such recommendations to Governmental

authorities at all levels regarding Tax legislation as may seem desirable as a result of the study, research and investigation carried on by The Foundation.

At the time of preparation of this submission, application for Letters Patent incorporating the Foundation as a non-profit corporation under Part II of the Dominion Companies' Act had been made. It is hoped that by the date of The Commissions' hearing the Letters Patent will have been granted.

The Foundation is supported by businesses and business groups from across Canada interested in the achievement of an equitable Income Tax system.

Value of Fair Competition

1. This Foundation is aware that it is not necessary to emphasize to the Members of this Royal Commission the desirability of establishing a climate of fair competition for all businesses trading in this country.

One does not have to be an economist to appreciate that if this condition is not achieved we shall not, as a nation, develop our full potential.

Governments, at their various levels, have always been the most important arbiters of treatment of those trading within their spheres of influence. Never is this more

true than today. In our own country the Federal Government especially has power to make or break any industry or any business within an industry. In many areas the Federal Government has recognized the extent of its power and has striven both to achieve fairness between competing sectors of the economy and to preserve the freedoms of the market place between companies in the same industry.

A few years ago the Government of our country provided concrete evidence of its desire to refrain from action which disturbed the competitive balance within industries. This it did by applying the same measure of income taxation to crown corporations as was applicable to ordinary corporations. This measure was not, of course, a guarantee that every business which would be competing with a crown corporation could expect in all ways to be treated on all fours with the latter. Obviously the Government still has in its power to favour the crown corporation over the ordinary business by the grant of licenses and franchises. The crown corporation might also have special advantages in its access to development capital, et cetera. In recent years, however, it has been the policy of the Federal Government

to limit the adoption of such practices. It is no doubt obvious to the Government that if ordinary business is to survive at all in industries where crown corporations are active the latter must not be specially favoured.

The step which the Government took regarding the taxation of crown corporations was indeed a significant one for, in the present era when income taxation is far and away, most businesses' largest individual expense item, fair competition demands that the same amount of taxes be collected from all businesses earning similar profits. If equality between businesses is not preserved then other competitive factors being equal, the privileged sector will outstrip its unprivileged rivals at a speed relative to the size of the disparity in their respective tax rates.

It is our belief that in the taxation of Co-operatives as compared to the taxation of ordinary businesses, there exists an extreme inequity. This treatment has induced an unnatural rate of growth in Co-operatives and Credit Unions and on the obverse side has brought about the failure or the forced sale to Co-operatives of businesses in competition with them. (Schedule "A".)

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(Schedule "A".)

Reasons for Commission concerning itself with particular Taxation inequities.

2. We believe that two circumstances resulting from the inequity make the whole subject deserving of study by the Commission.

i) To obtain adequate financing at reasonable rates, whether in the form of new capital or temporary loans from a bank or other lender, a business must have a reasonable expectation of earning adequate profit. To earn such profits, the business must be able to compete successfully with other businesses in the same field. If certain of a business's competitors are paying on similar profits only 1/10th the amount of income tax paid by the business seeking a loan, then the latter's prospects are obviously going to be adversely affected.

Inevitably such a situation will lead the prospective lender either to refuse to make the loan or else to charge a rate of interest which makes due allowance for the very considerable risks involved. It is precisely these circumstances which have occurred when an ordinary small business has found itself pitted against a Co-operative.

Reasons for Commission concerning [illegible]

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(1) To obtain adequate financing at reasonable rates, whether in the form of new capital or temporary loans from a bank or other lender, a business must have a reasonable expectation of earning adequate profit. To earn such profits, the business must be able to compete successfully with other businesses in the same field. If certain of a business's competitors are paying on similar profits only 1/10th the amount of income tax paid by the business seeking a loan, then the latter's prospects are obviously going to be adversely affected.

Inevitably such a situation will lead the prospective lender either to refuse to make the loan or else to charge a rate of interest which makes due allowance for the very [illegible] is precisely these circumstances [illegible] ordinary small business has found itself pitted against a Co-operative

ii) Co-operatives and Credit Unions have been able to use a large part of their untaxed profits for expansion purposes and have in this way had a distinct advantage over their competitors in ordinary business. The latter, whether they be corporations or individual traders, must pay tax on every cent of their profits before they can plough back any part of them for development purposes. (The extent to which profits are used as a source of capital must be well known to the Commission). The ability of Co-operatives to operate in this way has been one of the chief factors in Co-operative and Credit Union growth in recent years. The benefits not only permit existing Co-operatives to expand on funds derived from their own untaxed profits, they permit them to establish new Co-operatives in other districts or in other lines of endeavour. Thus, growth of the whole Co-operative movement is fostered by the facility with which Co-operatives can transform profits into capital.

The concessions granted Co-operatives and Credit Unions are reflected in the higher tax rates paid by all other taxpayers. These concessions are nothing short of a huge subsidy granted to every Co-operative and Credit Union in Canada. (A subsidy can be just as effectively granted by tax remission as by payment in cash.) If subsidy is to be granted to any business or industry, then it is essential it should be branded as such so that its extent can be known to all and so that the necessity for granting it can be frequently examined.

It is obvious that the urgency of the situation is much more pronounced than it was when income tax rates were moderate. When tax rates applied to some businesses range as high as 52%, a concession which enables some Co-operatives to restrict their liability to 5% of their profits is of immense value. So long as differentials of this nature persist, it seems merely a matter of time until all business passes into the hands of the favoured group. If the Government is prepared to allow this situation to continue, then it should also be prepared to face the seemingly inevitable result -- the complete transference of all business to the Co-operative system, in fact,

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the socialization of the whole economy.

We believe that the two problems mentioned above, which are of particular interest to the Commission, can only be solved by the removal of the basic taxation inequities which cause them.

For this reason we intend to deal in considerable detail with the Co-operative tax problem. We shall urge that the Commission make recommendations for the removal of present anomalies. As the damage being done daily is permanent, the situation is one of urgency and can neither be postponed nor ignored.

Taxation of Co-operatives

3. (a) General

We wish to make it clear that in raising the subject of Co-operative taxation and in seeking the redress of what we regard as an unfair situation we are in no way maligning or attempting to conduct a vendetta against Co-operative trading organizations. The businesses we represent are happy to take on any competition, co-operative or otherwise. All they ask is that the ground rules be the same for everyone.

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explored in two studies published by the Canadian Tax Foundation -- a body whose work will be well known to the members of the Commission. The Canadian Tax Foundation was most anxious that these studies, like all its others, should be objective and impartial. For this reason, it engaged a well known economist from the academic field - Professor R. Craig McIvor of McMaster University, to carry out the work. Professor McIvor owes allegiance to neither faction in the controversy and it is believed that the objectivity at which the Tax Foundation aimed is apparent from the tenor of the studies. These works are entitled "The Post-War Taxation of Canadian Co-operatives" (published in 1959) and "Recent Growth in Canadian Co-operatives" (published in 1962). Frequent reference to the latter of these two authoritative works will be made in this section of the submission.

(b) Present Legislation

The sections of the Income Tax Act which have the effect of conferring a competitive advantage on Credit Unions and Co-operatives are sections 62 (1) (k), (Credit Unions) 73 (New Co-operatives) and 75 (Ordinary Trading Co-operatives). (Schedule "B".)

The position of Credit Unions will be dealt with separately below.

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The three year exemption from tax granted new Co-operatives is certainly the most obvious and clear cut of all Co-operative tax advantages. However, by far the most significant Tax preferences given Co-operatives are those stemming from Section 75, which of course applies to both Co-operatives and ordinary companies. In brief, this section provides that a corporation, co-operative or otherwise, can, subject to certain restrictions, deduct, in computing its income from a taxation year, patronage dividends paid to customers. The taxpayer is permitted to vary the rate of patronage as among various classes of goods and service sold or provided and as between member and non-member customers. Non-member customers may be excluded from such payments. By Section 75 (2) the allowable patronage dividend payments to members may not exceed that part of the income of the taxpayer deemed to have arisen from its business with its members. Section 75 (3) prohibits a taxpayer from eliminating its income altogether by the payment of patronage dividends. It provides that the taxpayer may not, by the payment of patronage dividends, reduce its income below an amount equivalent to three percent of the capital employed in the business, less interest paid on loans to other than banks and credit unions.

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Section 75 (4) provides that "payment" of patronage dividends can be achieved for the purpose of the Act by a variety of ways. These methods of "payment" include cash, revolving fund arrangements, the issue of new share capital and various schemes, whereby dividends are declared contemporaneously with the exaction of a loan of a similar total amount from all the members.

The effect of this legislation as applied to Co-operatives is that income tax must be paid on the greatest of (a) the total un-allocated profit earned, (b) the profit arising from non-member business that is not distributed to non-members or (c) that amount of current profit equal to three percent of capital employed (less allowable interest payments). As a result, by declaring patronage dividends but contemporaneously arranging for the issue of new share capital, revolving fund arrangements and "forced loans" Co-operatives can build up large amounts of capital from untaxed profits.

Patronage dividends paid in respect of purchases of consumer goods are not taxable in the hands of the customer. Other patronage dividends whether or not paid in cash are taxable if the customer is in a tax paying bracket. They are, of course, taxable at

the customer's individual tax rate.

(c) Applications of Section '75' to Ordinary Corporations and Co-operatives

It is not possible for ordinary corporations to make significant use of Section 75 of the Act. The managements of such corporations owe a duty to account for their corporations' profits to their suppliers of risk capital - their shareholders. This duty they can only fulfill by paying dividends on share capital. On the other hand, Co-operatives can fulfill their duties to their suppliers of risk capital by paying patronage dividends for their customers are also their suppliers of this type of capital.

It is nonsense to argue, as certain Co-operative partisans do, that because the provisions of Section 75 are available to ordinary corporations as well as Co-operatives, no discrimination exists. The position is well summed up in the publication "Recent Growth in Canadian Co-operatives" at page 36:

"It is of course obvious that because of differences in structure and organization as between Co-operatives and ordinary corporations, the payment of patronage dividends may be employed much more effectively by the former where the benefit of such payments

accrues directly to the owners of the enterprise. In ordinary corporations, such payments reduce the equity of owners and have therefore been established only in exceptional circumstances. In practice, their use of patronage dividends as a means of reducing taxable income is impracticable, being inconsistent with the purpose of ordinary corporate enterprise and with its continuity. To point out, as is frequently done, that ordinary corporations are free to reorganize as co-operatives is not to deny but to affirm the reality of discrimination as between the two forms of organization. The essence of this discrimination lies in the fact that whereas section 75 (1) makes no discrimination in the "quality" or nature of income earned by co-operatives and by ordinary corporations, it does make a distinction in the taxing of such income, depending upon the particular pattern in which it is distributed. If the enterprise chooses to distribute these net earnings with reference to patronage, Section 75 (1) becomes applicable in reducing taxable income; if it distributes earnings with reference to share capital, Section 75 (1) does not apply. Among the possible objectives of such tax legislation, equity is one which

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does not appear to be achieved by a situation in which the differential treatment rests solely upon the particular internal pattern of claims upon earnings which the enterprise chooses to adopt."

It is the belief of those opposed to present laws governing Co-operative taxation that no distribution of profits to the owners of a business should go untaxed. Every such action must increase the tax burden on those who, in practice, cannot adopt the course of paying patronage dividends.

For those businesses in direct competition with Co-operatives the problem is intensified because of the ability of Co-operatives to amass untaxed capital for expansion from that portion of patronage dividends declared, but merely credited to the member on the books of the Co-operative.

The value of the privilege of funnelling two thirds or more of a business' profits, tax free so far as the business is concerned, into funds for capital development and expansion can probably be appreciated best by those who have been charged with the responsibility of expanding a business paying 52% of tax on every dollar it earns. Co-operatives have been quick to seize on the privileges open to them and published figures of some

of the bigger Co-operatives have shown that on individual annual profits of several millions of dollars they have paid as little as 5% of tax.

In the case of sales of consumer goods the small amount of tax paid by the Co-operative is the only tax paid on its profits. In the case of other types of Co-operative business, the member will, as has been mentioned, pay tax on his patronage dividends, if he is in a taxable bracket. Here it must be appreciated, however, that many recipients will be in a comparatively low tax bracket so that if the total tax paid by a corporation and its individual shareholders is compared with the total tax paid by a Co-operative, which earned the same profit, and its members, the tax contributions of the ordinary corporation and its members would be found to be several times as great as that of the other group. This would be the case even after taking into consideration the individual tax credit provided for under Section 38 (1) of the Act.

(d) Comparison of tax paying obligations of Co-operatives, ordinary corporations and others

It might be illuminating to compare the income tax-paying obligations of two corporations, one organized on a joint-stock basis, and the other on a Co-operative basis

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(6) Comparison of tax paying obligations of Co-operatives, ordinary corporations and others

It might be illuminating to compare the income tax-paying obligations of two corporations, one organized on a joint-stock basis, and the other on a Co-operative basis

and both having the same net profit of $200,000.00 at the end of their trading year. (For the purpose of illustration it would be assumed that the entire business of both companies was carried on within the Province of Saskatchewan where many Co-operatives are operating and where the combined effect of the Provincial and Federal Income Tax Acts is to require ordinary corporations to pay a maximum rate of 51% on their profits.)

The Co-operative might declare a patronage dividend to its members in the amount of three quarters of its profit. On this sum of $150,000.00, perhaps $50,000 would be distributed in cash and $100,000.00 would be credited to the accounts of the patrons in one bookkeeping operation, but loaned back by them to the Co-operative in a second, carried out contemporaneously with the first. The Co-operative would deduct the whole $150,000.00 from its profits and so would have a taxable income of only $50,000.00. On this taxable income it would pay federal income tax at 21% on the first $35,000.00, 50% on the balance plus provincial tax of 1% on the whole. Its total income tax payment would be $15,350.00 or 7.6% of its earnings.

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hand, because of its corporate structure, would probably find it impractical to pay patronage dividends and the whole of its net earnings of $200,000.00 would be taxable. Paying federal income tax at 21% on the first $35,000.00 of taxable income, at 50% on the balance and the provincial tax at 1% on the whole the joint-stock corporation would pay a total of $91,850.00, or 45.92% of its profit in tax. On the same earnings this company contributes over six times more tax than the Co-operative.

The competitive disadvantage of the ordinary corporation in the above example is obvious. For competitive purposes, it is not significant to those organizations how the profits they distribute, one by dividendpayments, the other by patronage dividends, are taxed in the hands of their shareholders or members.

However, the disparity in the tax contribution made from the Co-operative's profits (by the Co-operative and by the individual members), as compared with the total tax contributions made from the ordinary company's profits (by the company and its shareholders), is often just as great as in the situations where regard is paid only to the contribution of the trading organizations

alone.

In the case of a Co-operative marketing consumer goods, the tax paid by the Co-operative is the only tax paid on its profits; patronage dividends are tax free in the hands of the members.

In the case of other Co-operatives, patronage dividends are taxable in the hands of members, if the latter are in a taxable bracket. It is difficult to estimate the amount of Income Tax which would be paid by members in a case such as the one quoted above. Many payments would be of small amounts individually, and might well be overlooked by both taxpayer and the Department. It would probably be extremely seldom that the tax paid by the members would exceed the small amount of tax paid by the Co-operative.

In the case of an ordinary company, there would be no special consideration for a company dealing in consumer goods. It is reasonable to suppose that even after making allowance for the 20% Canadian dividend credit, the shareholders of an ordinary company would collectively, because of the certainty with which dividends are traced, pay at least as much and probably a good deal more individual tax than the Co-operative members on their patronage dividend.

Inequity of taxation is most evident between an incorporated trading company on the one hand and a Co-operative on the other. As the Commission will be well aware, incorporation by no means implies that a business has great financial reserves or an exceptional volume of business. Very many small businessmen find that only by means of incorporation can they provide their backers and lenders the stability which they require. In many cases, because of the amount of capital required and the number of persons involved, incorporation is more a requisite, rather than an optional method of conducting business. It is therefore not realistic to say that by incorporation, any business voluntarily exposes itself to the vigours of corporate taxation.

However, even in the case of those businessmen whom circumstances do not force into incorporation, there is often a significant inequity between their tax obligations and that of their Co-operative competitors. The following example sets out the respective tax obligations of an individual and a Co-operative, both engaged in the grocery trade, and both having a net profit of $10,000.00 at the end of a year.

Co-operative in Grocery Trade		Individual in Grocery Business	
Net profit for current year	$10,000.00	Net profit	$10,000.00
Less Patronage Dividends (whether paid in full or partly retained in business)	7,500.00	Less Allowance	2,500.00
	$ 2,500.00	Taxable Profit	$ 7,500.00
Tax Payable (Federal and Provincial) (22% on $2,500)	$ 550.00	Tax Payable (After giving effect to Federal and Provincial adjustments)	$ 1,616.40

(e) The Nature of Co-operatives as it affects their Tax Paying Obligations

Co-operatives can be divided into two categories. There are first "agency" or true Co-operatives which conduct their affairs at cost and consequently without profit. They act as agents of and for the exclusive account of their individual members. An example of such a Co-operative might be found in the case of a group of poultry farmers who commissioned one of their number to market the eggs produced by all of them so that they could command the better prices and reduced

expenses available to a volume seller. If the individual commissioned to perform the marketing, collected the eggs from his neighbors on consignment, marketed them, and accounted to the producers for the price realized, less the expenses of sale, this would be an example of a true "agency" Co-operative. Similar examples might be found in such fields as Co-operative housing. In these cases no profits or income are earned and so under our present system of taxing income, no liability to tax arises.

The other type of Co-operative is the trading Co-operative. This category embraces Co-operatives who engage in business, incur risks of profit and loss and conduct themselves like an ordinary business.

What starts out originally as a true agency Co-operative may easily evolve into a trading Co-operative. Suppose, for instance, the egg producers incorporated as a Co-operative and, by borrowing, found the money for building an egg grading and packing plant. Suppose then, a manager and staff were hired and the enterprise extended its activities into other fields, such as dairying, including milk processing and butter manufacturing. The expert management of the concern might find it profitable to deal in the produce markets in respect of the

expenses attributable to such sales. If the individual commissioned to perform the marketing, collected the eggs from his neighbors on consignment, marketed them and accounted to the producers for the price realized, less the expenses of sale, this would be an example of a true "agency" Co-operative. Similar examples might be found in such fields as Co-operative housing. In these cases no profits or income are earned and so under our present system of taxing income, no liability to tax arises.

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[illegible]

products it was handling. It might also be found profitable to rent part of the Co-operative's premises to ordinary commercial tenants and perhaps also to establish a wrapping and box-making division, not only to handle the Co-operative's output, but also to take on ordinary commercial work when occasion arose. The growth would be financed by the retention within the business of declared, but undistributed, patronage dividends.

It is interesting to note that it would be quite possible that in any year one section of the business - say that of egg marketing, would be carried on at a loss. However, the box-making and other sectors of the business might trade successfully, so that at the end of the year, the business as a whole would show a profit. Patronage dividends would be paid to all those members who delivered produce to the Co-operative during the year. However, the business done with a member who only delivered eggs to the Co-operative had resulted in nothing but a loss to the business. Yet such a member would share in the profits. This member was simply deriving a share of the profits of the enterprise as a whole. He was obtaining a return on the capital he and the

products it was handling. It might also be found profitable to rent part of the Co-operative's premises to ordinary commercial tenants and perhaps also to establish a trucking and box-making division, not only to handle the Co-operative's output, but also to take on ordinary commercial work when occasion arose. The growth would be financed by the retention within the business of [illegible]

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other members had invested in the business in previous years. In other words, his position was just like that of a shareholder in an ordinary company.

In this example the Co-operative enjoyed all the benefits which can be derived from trading as an incorporated body, without its most onerous obligation - the liability to full corporate taxation.

The issues were again well summed up in the publication "Recent Growth in Canadian Co-operatives" mentioned above. The author stated at Page 36:

"It is a basic aim of co-operative enterprise to operate on a non-profit basis on behalf of their members. Sometimes they succeed from a legal standpoint and sometimes they do not". As pointed out earlier, they do succeed legally where an "agency" relationship with their members can be established. Where they do not succeed, and are deemed legally to earn profit, they nevertheless contend that such profit is not comparable to that of ordinary corporations, being really in the nature of a "price adjustment". This view not only finds no support in the Canadian Income Tax Act but was rejected outright by the Royal Commission on Co-operatives, which conceded that a concept of "mutuality" might originally have

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provided strong support for the view that co-operatives could earn no profit, but then noted that the concept of mutuality was scarcely applicable to Canadian co-operative business in recent times. In other words they were viewed as earning profit from trading ventures undertaken. Nor does the view that co-operatives' net surplus is not profit find much support outside the movement itself. As a recent careful study has stated this matter, it is rather that "co-operatives are organized to increase the gain of their members, and to the extent that they do have profits. A rebate is only such if paid to a person whose interest is <u>adverse</u> to that of the business which pays it." It is further noted that <u>"the source of the patron-members' real gain is the transactions of their associations with others whose interests are adverse to theirs. Their interest, like those of the stockholders of an ordinary corporation, are furthered by the operations of a separate and distinct business entity."</u>

The points of similarity between ordinary corporations and "trading" Co-operatives are striking, the points of dissimilarity few. Here are the points of similarity:

(1) Co-operatives and ordinary corporations

are both artificial bodies;

(2) They have interests which are similar to but separate and distinguishable from those of their individual owners, whether those owners be patrons or shareholders;

(3) Both earn income which is primarily the income of the business (only some of it may be passed on to the owners);

(4) Both retain profits within their organization to finance their expansion;

(5) Both take risks of profit and loss;

(6) Both enjoy all the services provided by the state and paid for by taxation.

The only dissimilarity is the manner in which they distribute their profits.

The ordinary business distributes it in proportion to the amount of capital risked by the shareholders, the Co-operative in proportion to the volume of business done by the members.

The one point of dissimilarity between the two types of organization seems an exceedingly slender and illogical one for the justification of the collection of widely divergent percentages of profit as tax.

The exemption from tax of true "agency"

Co-operatives is not attributable to any provision of the Income Tax Act. It arises because such enterprises do not earn any "profit" within the legal definition of this word.

There seems little doubt that the favourable tax treatment which Co-operatives received since their inception in other countries and particularly since 1930 in Canada is in large part attributable to the perpetuation of attitudes developed by Governments toward the first Co-operatives formed in Great Britain and North America. These original attitudes of Government were no doubt induced because of three characteristics common to the early Co-operatives but seldom found in those bodies as we now know them.

The early Co-operatives almost all had these attributes:-

1. They either met, or came near to meeting, the test of being true agency Co-operatives;
2. Their memberships were drawn from economically depressed strata of society;
3. They were considered a novel, indeed an experimental, method of doing business and there was considerable doubt as to whether the system would be viable.

Because of these characteristics governments were inclined to treat Co-operatives as though they were charitable or quasi-charitable institutions. In any event income tax rates were so low and the sphere of Co-operative activity so limited, that the concessions were not of a great deal of importance to either Co-operatives or their competitors. The factors which probably induced this special treatment are almost entirely absent from Co-operatives today. Most of them fall very clearly into the non-exempt category. Indeed they carry on business in a manner indistinguishable, so far as operation is concerned, from the methods of their fully taxed competitors. Their memberships include those from all levels in our society -- the prosperous as well as those from the average and lower income groups. Far from being an experimental type of business they are well able with their large reserves, expert management and ambitious plans for expansion, to compete with all other types of business. There seems little doubt that they could continue to compete effectively even if they had to bear a proportionate share of the tax burden.

However, in Canada, unlike the situation in many countries, certain Co-operatives paid

their full share of Income Tax just like ordinary companies. Other Co-operatives escaped payment because of the ambiguous wording of the legislation at that time. In 1930, the Government passed an amendment to the Income War Tax Act, which at the time and during the 30's was interpreted as exempting Co-operatives from taxation. In passing this legislation, the Government was apparently influenced by a decision of the Supreme Court in a tax case which had been brought against the Saskatchewan Co-operative Wheat Producers Association, and probably also, by the historical attitude towards the nature of Co-operative enterprises, which has already been described.

There seems no doubt now that it was wrong to interpret the result of the Saskatchewan case as an indication that all Co-operative businesses could be regarded as tax exempt, even under the ambiguous 1917 legislation. And of course, the historical attitude towards Co-operatives made no allowances for the changes in the nature of their operations, which had taken place in the years since their inception. In any event, it is clear that in the years succeeding 1930, the continuing changes in the nature and scope of Co-operatives -- the

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development of processing and manufacturing activities, the use of revolving funds, and the growth of subsidiary trading companies, meant that the activities of many Co-operatives actually should have attracted a tax liability under the 1930 legislation, although they were not assessed throughout the 30's. In these years, the matter was not of pressing interest to the country as a whole, because profits for all businesses were low and most individuals and businesses were pre-occupied with their own economic survival. When profits were again earned regularly, and the rate of Income Tax increased sharply as a result of the war, the subject became of significance once more. Assessments for taxes for previous years were made against several Co-operatives, but were held in abeyance when, in response to the dissatisfaction which was being expressed in the manner in which Co-operatives were escaping taxes, a Royal Commission was appointed. The 1946 amendments followed on that Commission's report.

There may of course be special types of enterprises conducted on a Co-operative basis which the Government considers require special encouragement or special incentives. One such type of activity which comes to mind is the Co-operative Eskimo workshop producing sculptures and other examples of Eskimo native

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art. It might well be that the Government would consider such work worthy of the nation's support. If it did, such action would probably meet with the approval of most of the citizens of this country. However, it is important that this support should not be given by way of tax privilege. Rather it should be labelled for what it is - a subsidy - and should be made specifically to the group considered deserving of it. It seems quite unnecessary to subsidize many large and prosperous businesses for the sake of assisting some specific deserving projects. The economic health of most Co-operatives today provides proof that they are far from being "charitable" enterprises.

(f) <u>History of Present Legislation</u>:

The present legislation dealing with patronage dividends is partly the result of the Government-of-the-day's interpretation of the recommendations of the Royal Commission of 1944 and 1945, and partly the result of amending legislation superimposed on this base. As has been mentioned, in the years prior to 1944 there was considerable dissatisfaction among both business and individual taxpayers because Co-operatives were not paying their fair share of the taxation load. Because of this unrest the McDougall Royal Commission was set up and directed to enquire

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into

"(A) the present position of Co-operatives in the matter of the application thereto of the Income War Tax Act and the Excess Profits Tax Act, 1940, and

"(B) the organization and business methods and operations of the said Co-operatives as well as any other matters relevant to the question of the application of income and profits tax measures thereto, and

"(C) the comparative position in relation to taxation under the said Acts of persons engaged in any line of business in direct competition with Co-operatives," and it was directed to report" . . . all facts which appear to them to be pertinent for determining what would, in the public interest, constitute a just, fair and equitable basis for the application of" (the said statutes) "to Co-operatives and to persons other than Co-operatives in respect of methods of doing business analogous to Co-operative methods, such as the making of payments commonly called patronage dividends and to make such recommendations for the amendment of existing laws as they consider to be justified in the public interest;"

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As a result of its hearings and studies, the Commission recommended

(i) that the law be amended "to provide for the taxation of Co-operative associations and organizations on the same basis as other persons";

(ii) that Co-operatives, ordinary joint stock companies and others be allowed to deduct amounts paid as patronage dividends provided that they were paid in cash or its equivalent within six months;

(iii) that newly formed Co-operatives be granted a three-year exemption.

As will be demonstrated later, it is considered that recommendations (ii) and (iii) mentioned above are inconsistent with recommendation (i). The legislation based on the Commission's recommendation was introduced in 1946/and with one important exception has remained in substantially unaltered form until the present day. The provisions introduced then, comprise most of Sections 73 and 75 of the Act as presently framed.

The chief exception is Section 75 (4) (f) (ii) which was introduced in 1948. This amendment, it is believed largely as a result of representations made to the

Government by the Co-operative Union of Canada, extended the meaning of the word "payment" to embrace the "forced loan" method of dealing with patronage dividends, which has been described above.

(g) Extent to which Expressed Aims of Royal Commission's Recommendations have been Achieved:

A reasonable interpretation of the Royal Commission's key recommendation - that Co-operative associations be taxed on the same basis as other persons - would lead one to expect that the Commission intended that a Co-operative and a corporation earning a similar amount of profit should at the end of a normal year's operations, have approximately the same liability and the same opportunities of limiting this liability.

If this was the Commission's expectation it has certainly not been realized in practice.

It is obvious that the Commission, when it recommended special treatment for new Co-operatives, intended that at least one exception to its general rule should be made. This point was conclusively dealt with in "Recent Growth in Canadian Co-operatives" at Page 33 as follows:

"It will be recalled that Section 73 (1) provides that no tax is payable on the

taxable income of a co-operative for each of the first three taxation years after its commencement of business. This provision is based on a recommendation made by the Royal Commission on Co-operatives in its 1945 Report in response to representations that 'in their early years, their (i.e. Co-operatives') financial difficulties may be greater, on the average, than those of similar ordinary companies.' At the present stage of development of the Canadian co-operative movement, where skilled management and strong financial support are commonly made available to newly organized enterprises, there is simply not adequate evidence to support such a generalization. It would be just as plausible, and as unwarranted, to advance precisely the opposite contention. This being so, it follows that Section 73 (1), applying solely to Co-operatives, is discriminatory both in form and in fact, and this is surely one area of taxation in which conflict between Co-operatives and ordinary corporations might well be reduced, either by extending the provisions of Section 73 (1) to all corporate enterprise (Co-operative and ordinary) or by repealing the legislation."

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So far as Section 75 is concerned, it may well have been thought by the Commission that they had established a measure of rough justice by introducing Section 75 (3), the limitation in regard to capital employed. Three percent represented the level of interest rates on Dominion Government bonds at the time the Commission was sitting and it may have appeared to the Commission that this provision would ensure at least some tax contribution from Co-operatives. That the effects of this provision have fallen far short of the probable expectations of its instigators is evident from a survey of the average rates of tax being paid by Co-operatives today. Further erosion of the equality of treatment ideal took place when the controversial addition to the definition of "payment" under Section 75 (4) (f) (ii) was added in 1948.

No disinterested observer could argue that Co-operatives are now taxed on "the same basis as other persons".

Again, the subject was dealt with in the more recent Canadian Tax Foundation Study:

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discriminate in favour of Co-operative enterprise and that the consequence of such discrimination is to provide Co-operatives with access to relatively large sums of tax-free capital to finance the establishment and expansion of their trading organizations. This access is of course enormously facilitated by their ability to allocate patronage payments in forms other than cash, thereby actually retaining the funds within the organization. These funds, as Co-operative officials freely concede, represent a crucial factor in their having achieved such a remarkable rate of growth since World War II, and this may well be much more important as an explanation of their generally increasing share of total sales in markets where they operate, than the steady improvement in managerial efficiency which has been achieved within the movement."

(h) Economic and Logical Reasons for Co-operatives Paying Fair Share of Income Taxation:

Many Co-operative managements argue that their organizations do not really make profits at all. They claim that Co-operative organizations are only vehicles for carrying out the aims of their members and that, therefore, profits should only be taxable in the

hands of these members. As has been demonstrated, this position is not supportable in fact. Once it is recognized, as our Income Tax Act has done, that Co-ooeratives do have income then it is abundantly clear that if a fair competitive situation is to exist, Co-operatives and ordinary corporations should be taxed on a basis which obliges all undertakings, regardless of nature of ownership, having similar profits, to pay similar amounts of tax.

Two other arguments advanced by Co-operative spokesmen in resisting any move to impose a fair rate of tax on Co-operative profits are:

i) That if their profits were fully taxed it would be possible for Co-operatives, by reducing their prices for goods and services, to eliminate both their profits and their liability to income taxation;

ii) That the solution to the Co-operative - ordinary business tax controversy is to remove corporate tax altogether instead of attempting to achieve equality in the imposition of taxes on Co-operatives and ordinary business;

If Co-operatives chose to do business in the manner suggested in argument (i) and so escaped all liability to income tax, ordinary business would have to meet this type of

competition. However, it seems most improbable that, in practice, Co-operatives would operate for long without attempting to earn the profits upon which every business depends for its future growth and indeed its survival. Without net earnings there would be no patronage dividends -- the Co-operatives would be sacrificing the ready source of tax free working capital which especially strengthens their competitive muscle. They would not have the advantage of tax free funds retained in the treasury by the stroke of a pen. (Financial Post September 8th, 1962).

The second argument is no more substantial than the first. Any Government of this nation is going to be obliged to continue to incur expenditures at, or more likely beyond, current levels. Whether we relish the prospect or not these seem to be the harsh facts of life in the latter half of the twentieth century. While it may be the pipe dream of every business man to envisage a world without corporate taxation, there seems little likelihood of this idyllic state coming about. What other source could provide the one and one-third billion dollars that is derived from the taxation of Corporate profits? (1961 Taxation Statistics, Page 11.) In every developed country of the western

world, taxation of Corporate profits has been regarded as a necessity, albeit an unpleasant one. In any event the problem confronting us is too urgent to await the necessarily protracted evolution of any alternative taxation system, if any there be. The problem must be tackled here and now in the context of our existing system.

There are other compelling reasons for requiring Co-operatives to shoulder their share of the tax load.

The revenues derived from taxation are used to defray the costs of running this country at federal, provincial and municipal levels. Co-operatives and their employees, members and customers derive just as much benefit from these services as do ordinary corporations and their employees, shareholders, and customers. The services of Government Departments, the protection of the armed forces, Government financed highways,subsidized transportation services, et cetera, are of as much value to Co-operatives as they are to ordinary companies. Until World War II, the extent of social services was limited. Nowadays, they comprise a large and growing share of our national budget. It is only fair that every sector of the Economy should bear its share of these

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costs. The employees and members of a Co-operative derive as much advantage from these services and benefits as do the employees and shareholders of ordinary companies.

Every dollar of tax which Co-operatives are excused is a dollar transferred to the shoulders of some other taxpayer. To the extent that this tax is borne by others, even if they are not in direct competition with Co-operatives, the competitive position of these companies is adversely affected.

Co-operatives are doing approximately $1,400,000,000 of business a year in this country. It is believed they earn profits of well over $100,000,000 per annum. This figure is only an estimate but it is believed to be a modest estimate. On this sum they pay tax at an average rate of well under 10%. Were they to pay tax at the same levels as other corporations, it would be possible to lower the standard corporate tax rate by several percentage points.

The author of "Recent Growth in Canadian Co-operatives", after pointing out the discriminations which existed in favour of Co-operatives in our tax laws, drew attention to the misallocations of our national resources

which resulted from this discrimination, as follows:

> "If this" (the author is referring to the extra-ordinary rate of growth which Co-operatives enjoy through being able to use untaxed profits for development) "is correct then present tax arrangements are undesirable not only because of lack of equity but because of their effects on the efficiency with which the economy's productive resources are allocated. More specifically the allocation of resources as between Co-operatives and ordinary enterprise is under such circumstances then determined not primarily on grounds of productive efficiency but on the financial advantage accruing to the Co-operatives under present tax arrangements."

One flagrant example of the misallocation of resources discussed above in general terms, is of very topical significance at this time. Co-operatives happen to be concentrated largely in the distributive, marketing and service sections of the economy rather than in the primary and manufacturing industries. It is, of course, the success or failure of the latter group which determines the health of our whole economy. It is reasonable to

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suppose that the bulk of the taxes which Co-operatives escape paying, are being transferred to the wealth producing sectors of the economy and have the effect of making competition all the more difficult in both home and export markets for businesses in these sectors.

Continued favoured income tax treatment of Co-operatives must inevitably lead to more business passing to Co-operative control. This, in turn, will result in a reduction of corporate profits liable to taxation at normal corporate rates. Inevitably this circumstance will lead to further increases in standard corporate rates and the vicious circle will be nearer completion as increased rates drive more business into Co-operative hands. Ultimately, of course, some new method of raising corporate taxes would have to be found. Probably any Government would be moved to act some time before the complete transference of control of business to Co-operative hands took place. The action would be of small consolation to the enterprises which were forced to give up the unequal struggle between now and then.

Co-operatives do not balk at paying property and business taxes at the municipal level. They pay provincial sales and gasoline

taxes but have escaped almost all the burden of the taxes on corporate profits recently imposed by certain provinces to finance hospitalization schemes, et cetera. The purposes to which these tax revenues are put are no more important than those to which federal tax revenues are devoted. There is no valid reason for Co-operatives failing to pay their fair share of federal Government costs when they accept most of their obligations at the less costly local level.

(i) Co-operative Growth Rates:

It is not possible to state that all the gains in business volume which Co-operatives have achieved can be attributed to taxation advantage. However, such is the extent of Co-operative tax privilege it is reasonable to state that a significant proportion of the abnormal growth rates which Co-operatives have enjoyed in recent years is so attributable.

As has been mentioned Co-operative sales volume now amounts to some $1,400,000,000 per annum. This volume represents a doubling of the 1947 figure. Growth has been most pronounced in recent years. Between 1957 and 1960 Co-operatives' assets and their marketing sales both increased by 25%. In the same period merchandising sales increased by 29% and the sales of wholesale Co-operatives

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by 36%.

In almost all sections of the Economy the gains in sales volume achieved by Co-operatives have outstripped, and in some cases far outstripped, the growth shown by total Canadian sales. Examples of areas where Co-operatives have achieved much better than average results are in the hardware trade (since 1958 Co-operative sales have increased 40% against an increase in total Canadian sales of 8%) in the clothing and home furnishings trade (since 1945 Co-operative sales have increased 300% while total Canadian increases have been less than 200%) and in the wood and building materials trade (where in the post war years the record has been similar to that in the clothing and home furnishing trade).

The 1962 publication of The Canadian Tax Foundation had this to say about recent Co-operative growth:

> "The statistically proved rate of growth in Canadian Co-operative marketing, merchandising and wholesale sales since the end of World War II has, it will be generally conceded been striking. Moreover, these sales gains are impressive both when measured in absolute terms and when measured relative to the rate of growth achieved by competitors in the

'private' sector of the economy. It appears to be a fair generalization that Co-operative sales have grown a good bit more rapidly (and in a number of areas much more rapidly) than those of their competitors. To put the matter differently, the Co-operatives, in those areas of activity where they compete with 'private' enterprise, have substantially increased their share of total trade. We have shown that in the marketing of agricultural products, the Co-operatives' share of total trade (although not growing as rapidly) is very much greater than its share of total merchandising trade. What is most significant about Co-operative merchandising (and wholesaling) is not its present small share of total Canadian merchandising (and wholesaling) (a fact to be explained by its relatively recent development and relatively limited range of commodity groupings traded), but its very rapid growth throughout its still limited range of operations and the severe competitive pressures which it has been able to bring to bear on particular segments of the 'private' trade."

An example of the manner in which "particular segments" of the "private trade" can be affected by tax favoured Co-operative competition out of

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proportion to the extent of Co-operative activity in an industry, can be found in the retail trade. Co-operatives handle perhaps 3% of total Canadian retail trade. In Saskatchewan however, Co-operatives are estimated, by the Saskatchewan Retail Merchants Association, to have handled 8.63% of that province's retail business in 1961 and have outstripped department stores in sales volume ($77,695,318 to $67,847,000).

In addition to growth in business where Co-operatives have been established for many years, there has been evident of late a growing diversification of Co-operative activity into new fields. Co-operatives are now competing with ordinary fully taxed businesses in such diverse activities as retailing, wholesaling, lumber and building supply distributing, grain handling, dairying, food processing and manufacturing, fisheries, saw milling, operation of service stations, flour milling, seed crushing, manufacturing and distribution of feed products, chemical manufacturing, insurance in all forms and banking through Credit Unions. The concern as to Co-operative tax treatment which has been evident in industries such as retailing where Co-operatives have been active for some time is spreading with rapidity to the

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other industries in which Co-operatives are becoming active.

In Professor McIvor's later study, there was set out a summary of the views of those in ordinary business on the effect present Co-operative tax treatment was having on their own industries. Because of the significance of these views they are reproduced at length in Schedule "A attached hereto.

Credit Unions

4. The Commission will be familiar with the legislation of the various Provinces providing for the establishment and operation of Credit Unions.

The Commission will also be well aware of the scope of their activities and we do not intend to elaborate on these points.

The exempt status of these organizations arises under Sections 62 (1) and 62 (1) (k) of the Income Tax Act, reproduced in the schedule to this submission.

We are interested in the latter's tax treatment, first on grounds of principle and second, because they provide an excellent example of the progress which can be made by a section of industry accorded, in this case, not merely taxation advantage but taxation immunity.

The motives prompting the formation of Credit Unions included the encouragement of thrift and the provision of loans to members at moderate rates of interest. There seems little doubt that even without special taxation treatment Credit Unions would have developed and prospered. It has been explained it was not our intention to criticize Co-operatives as institutions. No more is it our desire to impugn or in any way discredit the aims of Credit Unions.

Were Section 62 (1) and 62 (1) (k) of the Income Tax Act not operative it seems unlikely that many Credit Unions would be able to achieve the status of "non income" agency Co-operatives. Few, if any, of them exhibit a strict "agency" relationship with their members. Credit Unions charge their borrowing members a higher rate of interest than they pay to their lending members. (A member of course, may be a borrower on one occasion and a lender on another). Credit Unions also show a profit on that part of their funds deposited by members which is invested in securities, loaned to trading Co-operatives, or otherwise placed on the money market. The profits Credit Unions earn from these sources are devoted to building up reserves, acquiring assets

The motives prompting the formation of Credit Unions included the encouragement of thrift and the provision of loans to members at moderate rates of interest. There seems little doubt that even without special taxation treatment Credit Unions would have developed and prospered. It has been explained it was not our intention to criticize Co-operatives as institutions. No more is it our desire to impugn or in any way discredit the aims of Credit Unions.

Were Section 62 (1) and 62 (1) (k) of the Income Tax Act not operative it seems unlikely that many Credit Unions would be able to achieve the status of "non income" agency Co-operatives. Few, if any, of them exhibit a strict "agency" relationship with their members. Credit Unions charge their borrowing members a higher rate of interest than they pay to their lending members. (A member of course, may be a borrower on one occasion and a lender on another). Credit Unions also show a profit on that part of their funds deposited by members which is invested in securities, loaned to other Co-operatives, or otherwise placed on the money market. The profits Credit Unions earn from these sources are not tax ... building ... reserves, acquiring assets

(buildings, office equipment, et cetera) and paying dividends to members. Indeed, the nature of their activities is very similar to that of their fully taxed competitors -- banks, savings and loan, trust, and finance companies. It is apparent that were it not for the special exemption accorded them under the Act, Credit Unions would be considered to earn income and would be subject to tax on their profits in the same way as is a trading Co-operative.

The tax exemptions granted Credit Unions were the result of specific recommendations in the Report of the McDougall Royal Commission. No suggestion was made in that Report, as it was in the case of Co-operatives, that at least some tax should be collected from their profits. Perhaps this was because Credit Unions were then both numerically and on a volume of business basis of little significance. They have now developed to a stage where their tax status requires review.

The growth which Credit Unions have enjoyed over the last twenty years has certainly been striking, as demonstrated by the following table:-

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The growth which Credit Unions have enjoyed over the last twenty years has certainly been striking, as demonstrated by the following table:

GROWTH OF CREDIT UNIONS IN CANADA

Year	Number of Members	Number of Credit Unions	Total Assets	Loans Granted Since Inception
1930	45,000	194	$ 11,000,000	$ - *
1941	238,463	1,316	31,230,813	126,898,678
1957	2,084,568	4,349 (4,060 Reported)	846,264,367	2,229,719,405
1958	2,187,494	4,485 (4,156 Reported)	1,009,363,000	2,614,197,000
1959	2,347,317	4,566 (4,137 Reported)	1,154,645,000	3,081,754,000
1960	2,544,300	4,667 (5,287 Reported)	1,299,000,000	- *

* - Figures not available.

In the last ten years the growth accelerated. It was stated in the Publication "Credit Unions in Canada, 1960" distributed by the Economics Division, Canada Department of Agriculture:-

"Comparative Statistics for 1960 and 1950

Credit Unions in Canada have experienced rapid growth during the past ten years. Credit Unions reporting increased from 2,801 in 1950 to 4,287 in 1960 (Table 8). Total membership increased from 1,508,125 to 2,544,300 during the same period. The greatest increase in membership was reported for British Columbia with 376 thousand

followed by Quebec with 365 thousand and Saskatchewan with 307 thousand. The average membership per credit union increased from 370 in 1950 to 593 in 1960.

Savings increased from $300 million in 1950 to $1,195 million in 1960. During the same period savings on a per member basis increased from $290 to $470.

(The Tables to which reference is made are not reproduced in this submission.)

It seems clear that much of the growth of Credit Unions can be directly attributed to their freedom from taxation. It is obvious that an organization which has no tax to pay on its profits is in a position to offer loans at lower rates and accept deposits at higher rates, than can a competitor who does have a substantial tax obligation. It is difficult to predict what percentage of the business Credit Unions now do that would have been conducted through the tax-paying channels of banks, savings and loan,trust and finance companies had tax been collected from Credit Union profits. It seems certain however, that the volume would have been substantial. Similarly, it is difficult to estimate the total sum which ordinary taxpayers have had to pay in tax over the years to compensate for the concession given

Credit Unions. The figure must, again, be large.

The extraordinary growth and prosperity which Credit Unions have enjoyed in the last twenty years and the unfair nature of the competition they provide for their fully taxed commercial competitors is sufficient reason for a reappraisal of the taxation policy to be adopted towards this type of financial business.

There seems little doubt that Credit Unions would be well able to fulfill the role they are presently playing in our society even though they were asked to bear the same share of the cost of running the country which other organizations performing similar functions have been doing year in and year out during the period of their growth. We urge that the Royal Commission recommend that the special exemption granted Credit Unions be revoked and that they be taxed on the same basis as ordinary financial concerns.

Conclusions and Recommendations

6. It is the view of the Foundation that the considerable disparity which exists between the treatment of Co-operatives and ordinary businesses result in the latter being placed in a disadvantageous position. It is further believed that perpetuation of

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Conclusions and Recommendations

6. It is the view of the Foundation that the considerable disparity which exists between the treatment of Co-operatives and ordinary business must result in the latter being placed in a disadvantageous position. It is further believed that perpetuation of

this tax inequality will intensify the problem and lead to more and more business passing to the control of Co-operatives.

In the present context the difficulties which ordinary businesses in competition with Co-operatives and Credit Unions experience in obtaining credit and raising new capital are severe enough to warrant that the Commission take cognizance of the overall implications of the Co-operative taxation system.

In the light of the material which has been included in this submission, the Foundation respectfully requests the Commission to make the following recommendations:

(1) In respect of ordinary Co-operatives

(a) That the key recommendation of the 1945 Royal Commission on Co-operative Taxation (to the effect that corporations and Co-operatives should both be taxed on the same basis) be implemented in a manner which results in both Co-operatives and ordinary companies with similar profits paying similar amounts of tax.

So long as corporate taxation is

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based on the present general scheme of collection it is requested that the deduction of patronage dividends paid by Co-operatives and by ordinary corporations be disallowed in the calculation of net income.

(b) That the three year tax exemption accorded new Co-operatives be removed.

(2) In respect of Credit Unions

That the special exemption accorded to Credit Unions be discontinued and that they be taxed on the same basis as ordinary financial concerns.

All of which is respectfully submitted

THE EQUITABLE INCOME TAX FOUNDATION

SCHEDULE "A"

"RECENT GROWTH IN CANADIAN CO-OPERATIVES"
by
R. Craig McIvor
June, 1962
Pages 29 - 32

In the sale of lumber and building supplies, the co-operatives' recent gains in relative sales (i.e., relative to those of their competitors) have been particularly great, especially in the west, and these operations have expanded mainly in established centres where line and independent operators have sold for years. Changing geographic shopping patterns have affected the longer-established private operators more seriously, since the more recently-established co-operatives have been better able to conform to the changed patterns. These co-operatives "are now established in all the larger centres as well as in the smaller places where they have frequently bought out or squeezed out independent competitors". In the view of these competitors, co-operative lumber outlets are apparently able to compete successfully in any community, the explanation being in terms of a level of managerial efficiency not generally distinguishable from that of "private" dealers, combined with an access to capital, for financing both the establishment and subsequent expansion of the business, which cannot possibly be matched by private dealers, because of the income tax advantage accruing to co-operatives. During the past five years, while the number of "private" retail lumber outlets has been reduced by some one hundred and fifty, co-operative outlets have risen in comparable numbers.

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To halt this process of attrition, the private trade deems fundamental tax revision to be essential.

The hardware trade, another area of merchandising hard hit by co-operative inroads, offers a similar analysis. Here, as elsewhere, the total volume of sales has increased much more rapidly than the total number of retail outlets, and the co-operatives' share of total sales has grown in part from a more rapid expansion of existing store facilities and in part from the buying out or crowding out of competitors. The case was put that it has become very difficult for a wholesale house to find a buyer when an independent merchant wishes to sell. The financial resources required to take over the concern will usually be beyond the means of most individuals; but a co-operative, with its ready access to capital from various sources within the movement, can usually finance the take-over with relatively little difficulty. The trend in the distribution of ownership of retail outlets therefore presents much the same picture as in lumber and building supplies, and in both cases it is asserted that the co-operatives' superior access to capital, stemming from their tax position, renders inevitable the outcome of the competitive struggle, so that new "private" capital inevitably shuns such areas and its total share of the industry continuously declines. At the wholesale level, where the relative growth of co-operative hardware and equipment sales has been particularly striking, the financial resources of the co-operative "wholesales" have been

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employed to take full advantage of the increasingly urban emphasis in co-operative merchandising. The supply of their large urban shopping centres has been accompanied by a marked relative decline in the activities of "private" wholesale hardware outlets, the strength of which has been traditionally developed in the supplying of primarily rural areas.

In the merchandising of feeds and fertilizers, the co-operatives' relative gains have been more modest than in other areas, but nevertheless sufficiently great as to be viewed as "alarming" by many of their competitors. Co-operative entry into the manufacture and distribution of these products represents a subsequent diversification of what was initially an agricultural marketing operation. Their continuously increasing competitive strength in feeds and fertilizers, as reflected both by their rising proportion of total sales and of merchandising outlets, is again attributed primarily to tax advantage, and has eliminated competitors in particular geographic areas.

Before attempting to assess the validity of these representations concerning the tax advantages possessed by co-operatives, we shall include in our sampling of "private" views certain observations originating from the marketing sectors of the economy. Among these, dairying and grain marketing are chosen as representing areas where the strength of co-operative pressures has been not only traditionally great but rapidly gaining in recent years.

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In the dairy industry, during the past few years, the enlargement of the co-operative segment owes much to the taking over, by co-operatives, of productive facilities previously owned by individuals or "private" corporations, many of these purchases requiring very large financial commitments. (Footnote 7). In addition, dairy producers traditionally compete for sales through the granting of financial assistance to their retail outlets, and it is asserted that the co-operative dairies have been "conspicuous" in their willingness and ability to provide loans in amounts and on terms which "private" competitors find it very difficult to match. Apart from their retention of tax-free patronage dividends allocated to members, the co-operative dairies are said to have at their disposal certain other techniques conducive to the acquisition of capital - techniques not available to their private competitors. In particular, the daily receipt of milk and cream from members, paid for semi-monthly, provides a ready basis for a continuous financing of the co-operative, in that a very small percentage deduction from members' produce cheques, spread over a large number of members, will yield substantial funds for any new financial requirements. The financing of the Twin City Co-operative (see footnote 7) is a case in point, but the method is of course by no means limited to dairying operations.

The financial techniques of co-operative dairying provide an appropriate occasion for introducing another facet of co-operative finance, the significance of

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The financial techniques of co-operative dairying provide an appropriate occasion for introducing another facet of co-operative finance, the significance of

which extends far beyond this particular industry. It is open to any marketing co-operative, by the expedient of raising prices paid for produce acquired from its members, to avoid the accumulation of any surplus or profit. For a merchandising co-operative the same result may be achieved by lowering prices charged for supplies sold to its members. In either event, there is created what has become known as a "pricing-out" problem, in that the net earnings of the enterprise may be formally eliminated. They of course in fact remain, but they accrue to the members in different form, via the higher selling or lower purchase prices from which the members benefit. This problem is given further consideration below. In the dairying industry, the "private" firms assert that co-operative producers commonly distribute their earnings to members through higher payments for produce, thereby eliminating or reducing to a minimum the appearance of net surplus. They obtain necessary capital through regular deductions from members' produce cheques, a process which results in a continuous growth of members' equity in the enterprise. With this combination of techniques, "private" enterprise is unable to compete, and it is their view that if more equitable tax arrangements cannot be achieved, the co-operatives' share of the industry will continue to increase. While the co-operatives are steadily acquiring "private" dairies, there are no instances of "reverse" movements and the gradual but inevitable outcome will be the disappearance of the "private" sector of the industry.

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Within the fisheries industry, the relative growth of co-operative enterprise has been explained (as in other sectors) partly by their superior access to capital. In addition, however, the co-operatives have been free from fishermen's strikes which have frequently plagued their competitors. In point of fact, the co-operative organizations are associations of fishermen, and in turning over their catches to their organization for processing, the fishermen accept a cash down-payment which may be augmented by a patronage allocation at a later date. The "private" processing firms pay cash in full at time of purchasing the catch of independent fishermen and in certain provinces (e.g. British Columbia) it is illegal for these private firms (in any sector of production) to solicit products from co-operative producers.

The role of co-operative marketing in the Canadian grain trade has already been extensively discussed in the earlier study, and the case presented by the "private" dealers need only be summarized at this point. In this sector, co-operative marketing activities are centred in the three provincial "pools" and in the United Grain Growers Limited, an organization in some respects similar to the pools, in other respects to the "private" companies. The "private" trade, while not as highly concentrated, is nevertheless well organized and it is not surprising that with such a market structure the controversial issues relating to co-operative taxation have been most

sharply delineated and most extensively discussed in this sector. It is here, of course, that co-operative marketing developed its greatest strength and where its largest and most diversified operations are to be found. Since the end of World War II, and for some years before, the competitive position of the "private" trade has deteriorated. Thus, between 1946 and 1960, a familiar Canadian trend may be readily observed, that of the transfer of ownership of grain elevators from "private" to co-operative control. During this fourteen year interval, the number of country elevators operated by the "private" trade declined from 3689 to 3119, while the number operated by the three pools increased from 1773 to 2183. Over the same period, the percentage of country elevator grain deliveries in Western Canada taken by the pools increased from approximately 43% to 48%.

It is the position of the private grain trade that this continuous transfer of ownership of elevator facilities has been produced by the tax advantages which the co-operative elevator companies have long enjoyed. In particular, the pools' early elevator and commercial reserves (tax-free additions to their capital), continuously augmented by patronage loans (dividends "allocated" but withheld from members), have permitted these organizations unfairly to augment and diversify their operations at the expense of "private" dealers. Meanwhile, in an effort to slow the erosion of their competitive position, some

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of the latter firms have been compelled to institute the payment of patronage dividends, although on a scale necessarily more modest than those of the pools. As elsewhere, the comparative unattractiveness of the grain trade as an investment outlet for private capital has meant that the transfer of ownership of facilities has been a one-way process. The transfer is therefore not to be explained in terms of the greater efficiency of co-operative enterprise in this sector but rather in terms of tax discrimination; and the inevitable, if gradual, outcome is seen as the obliteration of the "private" trade.

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(7) As of late 1961, the most recent example of such a "take-over" was the action of the United Milk Producers, an association of 558 shippers of fluid milk to the Halifax-Dartmouth area in Nova Scotia. They established the new "Twin Cities Co-operative" as an instrument for acquiring ownership of Maple Leaf Dairy (and its subsidiary, Farmer's Dairy) at a cost of $1.3 million, and thereby gaining control over the distribution of three-quarters of all the milk sold in the Halifax-Dartmouth market. Membership in Twin Cities Co-operative cost $50, and since $200,000 in cash was required to effect the take-over, members were also asked for a contribution of $100 per can, for each can of milk quota they had. Further financing was to take the form of a voluntary continuing "check-off" of 25¢ per can, after the new co-operative took over, and

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profits were to be ploughed back into the business, in order to complete the purchase. Each producer would be "allocated" his profit in the form of additional share capital.

SCHEDULE "B"

CANADIAN INCOME TAX ACT

1961 Edition

Section 62 (Page 146) -- EXEMPTIONS

Section 62 (1)

(1) No tax is payable under this Part upon the taxable income of a person for a period when that person was

Section 62 (1) (k) Pages 149, 150)

(k) CREDIT UNIONS. - a corporation or association incorporated or organized as a credit union or co-operative credit society if

(i) it was restricted to carrying on business in one province and it derived its revenue primarily from

(A) loans made to, or cashing cheques for, members residing within the province,

(B) bonds of, or guaranteed by, the government of Canada or a province, or

(C) loans made to a co-operative credit society of which it is a member, or

(ii) the members thereof were corporations or associations

(A) incorporated or organized as credit unions substantially all of which derived their revenues primarily from loans made to members or from bonds of, or guaranteed by, the Government of

Canada or a province, legislation or governed by such legislation, or

(C) incorporated or organized for charitable purposes,

or were corporations or associations no part of the income of which was payable to, or otherwise benefited personally, any shareholder or member thereof;

Section 73 (Pages 179, 180) -- CO-OPERATIVES

Section 73 (1)

(1) 3-year exemption. No tax is payable under this Part upon the taxable income for each of the first 3 taxation years after commencement of its business of a corporation that commenced business on or after January 1, 1947, and that was incorporated under provincial legislation respecting the establishment of co-operative corporations for the purpose of marketing (including processing incident to or connected therewith) natural products belonging to or acquired from its members or customers, of purchasing supplies, equipment or household necessaries for or to be sold to its members or customers or of performing services for its members or customer, if, during the taxation year,

(a) the statute under which it was incorporated, its charter, articles of association or by-laws or its contracts with its members or its members and customers held forth the prospect that payment would be made to them

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governed by such legislation, or

(c) incorporated or organized for charitable
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Section 73 (1)

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(a) the statute under which it was incorporated, its charter, articles of association or by-laws or its contracts with its members or its members and customers held forth the prospect that payment would be made to them

in proportion to patronage,

(b) none of its members had more than one vote in the conduct of the affairs of the corporation,

(c) at least 90% of its members are individuals and at least 90% of its shares, if any, are held by individuals,

(d) the rate of interest on capital subscribed by its members or the rate of its dividends on its shares did not exceed 5% per annum,

(e) the value of the products marketed for or acquired from, supplies, equipment and household necessaries purchased for or sold to, and services performed for, its customers other than members did not exceed 20% of the total thereof for all its business, and

(f) the business carried on by the corporation was not a continuation of a previous business in which a substantial number of its members had a substantial interest, either as shareholders of a corporation carrying on the previous business or otherwise.

Section 73 (2)

(2) NON-APPLICATION OF PAR. (a), ss. (2), Sec. 81. Paragraph (a) of sub-section (2) of section 81 does

not apply where the corporation that redeemed or acquired its common shares or that reduced its common stock is a corporation that was incorporated under provincial legislation respecting the establishment of co-operative corporations for the purpose of marketing (including processing incident to or connected therewith) natural products belonging to or acquired from its members or customers, of purchasing supplies, equipment or household necessaries for or to be sold to its members or customers or of performing services for its members or customers.

SECTION 73 (3)

(3) PROVINCIAL GRANT. Where a corporation that was incorporated under provincial legislation respecting the establishment of co-operative corporations for the purpose of marketing (including processing incident to or connected therewith) natural products belonging to or acquired from its members or customers, of purchasing supplies, equipment or household necessaries for or to be sold to its members or customers or of performing services for its members or customers has received a grant from the government of a province that was not fixed by reference to natural products marketed, supplies, equipment or household necessaries purchased or sold or services performed by it,

(a) no amount shall be included in respect

of the grant in computing the corporation's income for any year, and

(b) paragraph (h) of subsection (6) of section 20 is not applicable in respect of any property in respect of or for the acquisition of which it was received.

Section 75. (Pages 181, 182, 183, 184)

PATRONAGE DIVIDENDS

Section 75 (1)

(1) Deduction in computing income. Notwithstanding anything in this Part, there may be deducted, in computing income for a taxation year, the aggregate of the payments made, pursuant to allocations in proportion to patronage, by a taxpayer.

(a) within the year or within 12 months thereafter to his customers of the year, and

(b) within the year or within 12 months thereafter to his customers of a previous year, the deduction of which from income of a previous taxation year was not permitted.

Section 75 (2)

(2) Limitation where non-member customers. Notwithstanding sub-section (1), if the taxpayer has not made allocations in proportion to patronage in respect of all his customers of the year

at the same rate, with appropriate differences for different types or classes of goods, products or services, or classes, grades or qualities thereof, the amount that may be deducted under this section is an amount equal to the lesser of

(a) the aggregate of the payments mentioned in subsection (1), or

(b) the aggregate of

(i) the part of the income of the taxpayer for the year attributable to business done with members, and

(ii) the allocations in proportion to patronage made to non-member customers of the year.

Section 75 (3)

(3) Limitation by reference to capital employed. Where the deduction of an amount under subsection (1) or (2) would result in the taxpayer's taxable income for the taxation year (before deduction of any amount under section 27 in respect of business losses) being less than the amount by which

(a) 3% of the capital employed in the business at the commencement of the year,

exceeds

(b) the interest, if any, paid on borrowed moneys (other than moneys borrowed from

a bank incorporated under the Bank Act or from a corporation or association described in paragraph (k) or subsection (1) of section 62) and deductible in computing his income for the year,

the amount that may be deducted under this section is such as will leave the taxpayer with a taxable income (before deduction of any amount under section 27 in respect of businesses losses) equal to the excess.

Section 75 (4)

(4) Definitions. For the purposes of this section,

(a) "allocation in proportion to patronage" for a taxation year means an amount credited by a taxpayer to a customer of that year on terms that the customer is entitled to or will receive payment thereof, computed at a rate in relation to the quantity, quality or value of the goods or products acquired, marketed, handled, dealt in or sold, or services rendered by the taxpayer from, on behalf of or to the customer, whether as principal or as agent of the customer or otherwise, with appropriate differences in the rate for different classes, grades or qualities thereof, if

(i) the amount was credited

(A) within the year or within 12 months thereafter, and

(B) at the same rate in relation to

quantity, quality or value aforesaid as the rate at which amounts were similarly credited to all other customers of that year who were members or to all other customers of that year, as the case may be, with appropriate differences aforesaid for different classes, grades or qualities, and

(ii) the prospect that amounts would be so credited was held forth by the taxpayer to his customers of that year who were members or non-member customers of that year, as the case may be;

(b) "capital employed in the business" shall be computed in accordance with the First Schedule to The Excess Profits Tax Act, 1940, except that no deduction shall be made from capital in respect of borrowed moneys (other than moneys borrowed from a bank incorporated under the Bank Act or from a corporation or association described in paragraph (k) of subsection (1) of section 62);

(c) "customer" means a customer of a taxpayer and includes a person who sells or delivers goods or products to the taxpayer, or for whom the taxpayer renders services;

(d) "consumer goods or services" means goods or services the cost of which was not deduct-

ible by the taxpayer in computing the income from a business or property;

(e) "income of the taxpayer attributable to business done with members" of any taxation year means that proportion of the income of the taxpayer for the year (before making any deduction under this section) that the value of the goods or products acquired, marketed, handled, dealt in or sold or services rendered by the taxpayer from, on behalf of, or for members, is of the total value of goods or products acquired, marketed, handled, dealt in or sold or services rendered by the taxpayer from, on behalf of, or for all customers during the year;

(f) "payment" includes

(i) the issue of a certificate of indebtedness or shares of the taxpayer or of a corporation of which the taxpayer is a subsidiary wholly-owned corporation if the taxpayer or that corporation has in the year or within 12 months thereafter disbursed an amount of money equal to the aggregate face value of all certificates or shares so issued in the course of redeeming or purchasing certificates of indebtedness or shares of the taxpayer or that corporation previously issued,

(e) "income of the taxpayer attributable to business done with members' of any taxation year means that proportion of the income of the taxpayer for the year (before making any deduction under this section) that the value of the goods or products acquired, marketed, handled, dealt in or sold or services rendered by the taxpayer from, on behalf of, or for members, is of the total value of goods or products acquired, marketed, handled, dealt in or sold or services rendered by the taxpayer from, on behalf of, or for all customers during the year;

(f) "payment" includes

(i) the issue of a certificate of indebtedness or shares of the taxpayer or of a corporation of which the taxpayer is a subsidiary wholly-owned corporation if the taxpayer or that corporation has in the year or within 12 months thereafter disbursed an amount of money equal to the aggregate face value of all certificates or shares so issued in the course of redeeming or purchasing certificates of indebtedness or shares of the taxpayer or that corporation previously

(ii) the application by the taxpayer of an amount to a member's liability to the taxpayer (including, without restricting the generality of the foregoing, an amount applied in fulfilment of an obligation of the member to make a loan to the taxpayer and an amount applied on account of payment for shares issued to a member) pursuant to a by-law of the taxpayer, pursuant to statutory authority or at the request of the member, or

(iii) the amount of a payment or transfer by the taxpayer that, under subsection (1) of section 16, is required to be included in computing the income of a member;

(g) "member" means a person who is entitled as a member or shareholder to full voting rights in the conduct of the affairs of the taxpayer (being a corporation) or of a corporation of which the taxpayer is a subsidiary wholly-owned corporation; and

(h) "non-member customer" means a customer who is not a member.

Section 75 (5)

(5) Holding forth prospect of allocations. For the purpose of this section a taxpayer shall be

deemed to have held forth the prospect that amounts would be credited to a customer of a taxation year by way of allocation in proportion to patronage, if

(a) throughout the year the statute under which the taxpayer was incorporated or registered, its charter, articles of association or by-laws or its contract with the customer held forth the prospect that amounts would be so credited to customers who are members or non-member customers, as the case may be, or

(b) prior to the commencement of the year or prior to such other day as may be prescribed for the class of business in which the taxpayer is engaged, the taxpayer has published an advertisement in prescribed form in a newspaper or newspapers of general circulation throughout the greater part of the area in which the taxpayer carried on business holding forth that prospect to customers who are members or non-member customers, as the case may be, and has filed copies of the newspapers with the Minister before the end of the thirtieth day of the taxation year or within 30 days from the prescribed day, as the case may be.

Section 75 (5a)

(5a) Saving provision. For the purposes of

amounts would be credited to a customer of a taxation year by way of allocation in proportion to patronage, if

(a) throughout the year the statute under which the taxpayer was incorporated or registered, its charter, articles of association or by-laws or its contract with the customer held forth the prospect that amounts would be so credited to customers who are members or non-member customers, as the case may be, or

(b) prior to the commencement of the year or prior to such other day as may be prescribed for the class of business in which the taxpayer is engaged, the taxpayer has published an advertisement in prescribed form in a newspaper or newspapers of general circulation throughout the greater part of the area in which the taxpayer carried on business holding forth that prospect to customers who are members or non-member customers, as the case may be, and has filed copies of the newspapers with the Minister before the end of the thirtieth day of the taxation year or within 30 days

(5a) Saving provision. For the purposes of

subsection (3), "3% of the capital employed in the business at the commencement of the year" means, in any case where the taxation year of the taxpayer is less than 12 months, that proportion of 3% of the capital so employed at the commencement of the year that the number of days in the year is of 365.

Section 75 (6)

(6) Customer's income. Where a payment has been received by a taxpayer in respect of an allocation in proportion to patronage (other than an allocation in respect of consumer goods or services), the amount thereof shall be included in computing the recipient's income for the taxation year in which the payment was received and, without restricting the generality of the foregoing, where a certificate of indebtedness or a share was issued to a person in respect of an allocation in proportion to patronage, the amount thereof shall be included in computing the recipient's income tax for the taxation year in which the certificate or share was received and not in computing his income for the year in which the indebtedness was subsequently discharged or the share was redeemed.

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